Part II

Background and evidence

3 Background to the proposed transfers and the companies involved

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Introduction

3.1. This chapter deals with the proposed transfers of newspaper titles and related assets owned by Mirror Group to Trinity and to RIM respectively and describes the companies involved, the proposed funding of the acquisitions and the strategies of the respective bidders.

3.2. An acquisition of Mirror Group would involve the transfer of 71 newspaper titles and more than 30 magazine titles (or similar publications). The newspaper titles include two national daily and two national Sunday titles circulated throughout the UK, three titles primarily sold in Scotland and five in Northern Ireland. In addition the transfer would include a portfolio of regional and local newspapers distributed mainly in the Midlands region of England including 9 daily, 1 Sunday, 10 paid-for weekly, 38 free weekly and 1 free monthly title. A full list of the titles in our terms of reference is set out in Appendix 1.1.

3.3. The proposed transfers were referred by the Secretary of State to us for investigation and report on 12 March 1999 (see Appendix 1.1).

Background to the proposed transfers

Trinity's proposed offer for Mirror Group

3.4. From March 1998, various discussions took place between the senior management of Trinity and Mirror Group in an attempt to bring the two companies together. In addition, Trinity approached Mirror Group's major shareholder, Philips & Drew, in early 1998 to establish whether it felt that such a proposal would be in its interests.

3.5. In May 1998 Axel Springer Verlag AG (Axel Springer), a German newspaper publisher, announced a possible offer for Mirror Group. At this point discussions terminated between Mirror Group and Trinity as they agreed, given that talks were only at an exploratory stage, that it would be inappropriate to progress the discussions until Axel Springer's intentions became clear. In June 1998 Axel Springer announced that it would not be making an offer for Mirror Group and dialogue between Trinity and Mirror Group reopened in the autumn of 1998. However, the parties were unable to agree on a structure for the enlarged group and the future roles of existing management.

3.6. Negotiations continued until 10 January 1999 when a story in the *Sunday Telegraph* caused Trinity to announce formally that it had broken off discussions. Also in January 1999, David Montgomery resigned and was replaced by John Allwood as Chief Executive of Mirror Group and RIM expressed an interest in acquiring Mirror Group. At that point, SG Hambros Corporate Finance Advisory (a division of Société Genérale), financial advisers to Mirror Group, decided to organize a more formal process which involved limited, high-level due diligence and meetings with senior management and advisers. On 26 February 1999 Trinity made an indicative proposed offer for Mirror Group of 0.35 new Trinity shares and 40p in cash for each existing Mirror Group share. The Mirror Group board rejected the proposed offer, which valued the equity in Mirror Group at £973 million, on the grounds that it reflected an inadequate premium for a change of control.

3.7. On 3 March 1999 Trinity decided to seek approval from the Secretary of State for the proposed merger despite its proposed offer having been rejected by Mirror Group. Given the need for consent of the Secretary of State to the transfer of Mirror Group's newspaper titles as required by the Fair Trading Act 1973, Trinity believed that it was in its interests to undergo an MMC inquiry before reconsidering terms or seeking a recommendation from the Mirror Group board. Trinity told us that its present intention was to proceed with a bid for Mirror Group in due course.

RIM's proposed offer for Mirror Group

3.8. On 14 January 1999, following discussions between RIM and Mirror Group, RIM made a formal approach to Mirror Group confirming its interest in pursuing discussions with a view potentially to making an offer for the company. A number of discussions were held with Philips & Drew prior to RIM making a proposal to Mirror Group management. The proposed offer was at an indicative price of 200p per share for the whole of the issued share capital of Mirror Group (valuing the group at about £913 million). Any formal offer was to be subject to a recommendation from the Mirror Group board and the consent of the Secretary of State following a mandatory reference to the MMC.

3.9. On 21 January 1999 Mirror Group rejected the proposed offer as not being adequate. However, it offered to enter into further discussions in order to determine whether RIM would be able to put forward proposals that the Mirror Group board would be able to take further. These discussions continued and RIM completed preliminary due diligence into Mirror Group's businesses in late February 1999.

3.10. In view of the application made by Trinity on 3 March 1999, RIM submitted its own application to the Secretary of State for his consent to the proposed transfer on 4 March 1999 so that its application could be considered alongside Trinity's.

The companies

3.11. In the following section we consider the history, development and financial position of Mirror Group, Trinity and RIM in turn.

Mirror Group

3.12. The origin of the newspaper business of Mirror Group goes back more than 100 years. The main titles were either established or acquired by the Harmsworth family and eventually formed part

of International Publishing Corporation Ltd (IPC). In 1970 IPC was sold to Reed International plc, which owned it until 1984, when the business was sold to companies controlled by the late Robert Maxwell and his family, who subsequently floated 49 per cent of Mirror Group on the London Stock Exchange in May 1991. Following Robert Maxwell's death in November 1991, financial irregularities were discovered and a number of Maxwell companies, including those that controlled Mirror Group, were put into administration.

3.13. 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 of Mirror Group was restructured and in September 1993 the administrators sold the Maxwell companies' controlling shareholding in Mirror Group to a number of institutional investors. On 31 March 1999 Mirror Group's main shareholders were still financial institutions, the largest of which (Philips & Drew) held 21 per cent. Mirror Group's market capitalization at 28 May 1999 was £1,052 million.

3.14. Mirror Group has acquired a number of businesses in recent years as part of its strategy to extend the scope of its media interests and to reduce its reliance on its national newspaper business. The most significant of its recent acquisitions occurred in November 1997 when Mirror Group acquired MIN, a regional newspaper proprietor with its main activities focused in and around Birmingham and Coventry (see Appendix 4.2, item 33, for previous MMC report). Following Mirror Group's acquisition of MIN it established a regional board for the Midlands, which is subsidiary to the Mirror Group main board and has a mainly non-executive role.

3.15. The principal activity of Mirror Group is the publishing and printing of daily and Sunday newspapers. Its main titles are sold throughout the UK, but it also publishes several titles either wholly or primarily sold in Scotland, Northern Ireland and the Midlands. Mirror Group is currently the third largest publisher of all newspapers in the UK and the second largest publisher of local and regional newspapers in the UK (on the basis that the *Daily Record*, *Sunday Mail*, *Sunday Post* and *Evening Standard* are classified as regional newspapers—see paragraphs 4.12 to 4.17). A list of Mirror Group's titles is set out in Appendix 3.1.

3.16. Mirror Group's main national titles in terms of circulation are *The Mirror, Sunday Mirror* and *Sunday People*. It also owns the *Racing Post*, a daily newspaper circulated in the UK, which is devoted largely to horse racing.

3.17. In Scotland, Mirror Group owns the *Daily Record* and the *Sunday Mail* as well as *The Glaswegian*. In Northern Ireland Mirror Group's subsidiary, Century Press and Publishing Limited (Century), publishes the *News Letter*, Northern Ireland's third largest circulation newspaper. Prior to May 1999, the *News Letter* was published in an Ulster edition (a daily paid-for title) and a Belfast edition (a four-days-a-week free title). The Belfast edition of the *News Letter* has now been relaunched as the *Belfast News*, a free weekly title. Mirror Group ceased publication of the *East Belfast News*, a free weekly title, at the time of the launch of the *Belfast News*. In 1998 Mirror Group acquired Derry Journal Limited which publishes the *Derry Journal* and the *Journal Extra* in Northern Ireland.

3.18. As a result of the acquisition of MIN, Mirror Group publishes a portfolio of daily morning and evening newspapers and weekly paid-for and free newspapers. The largest of these regional titles are *The Birmingham Post*, *Birmingham Evening Mail*, *Coventry Evening Telegraph* and *Sunday Mercury*.

3.19. Printing of Mirror Group's newspapers is carried out at seven print sites in the UK, at Watford, Oldham, Birmingham and Coventry in England; Glasgow in Scotland; and at Belfast and Derry in Northern Ireland. Its head office is at Canary Wharf in London Docklands, where the main editorial staff of *The Mirror* and other national titles are located. In 1998 it employed on average 5,565 full-time and 356 part-time employees.

3.20. As a consequence of its acquisition of MIN, Mirror Group acquired a magazines and exhibitions business, which publishes more than 30 specialist magazines and organizes consumer and trade exhibitions from a number of locations around the country. Mirror Group has recently expanded its magazine interests through acquisitions including that of First Press Publishing, a Scotland-based publisher of a range of mainly sport-related publications, in February 1999.

3.21. In addition to broadening its traditional interests in newspaper publishing, in recent years Mirror Group has sought to develop other media interests. It owns 90 per cent of Live TV, a 24-hour cable television channel, launched in June 1995 and noted for its News Bunny, which offers a combination of news, information and entertainment. The national Live TV channel, which operates from Canary Wharf, is customized in a number of UK cities so as to offer a combination of national programming and local news and features. There are local Live TV stations operating in Birmingham, Edinburgh, Manchester and Westminster. The stations formerly operating in Liverpool and Newcastle were closed in 1998 due to a combination of competitive forces and a lack of cable penetration. On 1 January 1999 around 2.5 million homes received the Live TV channel (in either its national or local city format).

3.22. Mirror Group has also been developing various Internet services and in March 1999 announced the creation of a new division, New Media and Interactive Services. Each of Mirror Group's national newspapers has its own web site as does the *Racing Post* and the group's major regional titles. Mirror Group also has a joint venture with the Press Association, which has launched the PA Sporting Life web site. During the 1998 Football World Cup this web site launched the UK's only fully automated on-line betting service (Bet-on-line). The site has recently launched a comprehensive betting service (Total-bet) across all sports, including horse-race betting in association with the Tote.

3.23. In an expansion of Mirror Group's Internet activities in February 1999 it entered into a strategic partnership with Zip2, a supplier of Internet platform solutions for media companies. Mirror Group told us that Zip2's Homebase media platform creates a one-stop-shop Internet portal, a user-friendly gateway to local, regional and national media services. Mirror Group became an Internet service provider in April 1999 with the launch of ic24.co.uk, a new portal site offering free access to the Internet in conjunction with Cable & Wireless, Compaq and Microsoft.

3.24. By 1995 Mirror Group had acquired a 20 per cent shareholding (subsequently reduced to 18.6 per cent) in SMG. Although a profitable investment for Mirror Group, the cost savings and synergistic benefits it had hoped for did not materialize and Mirror Group sold its shareholding to Granada Group plc for £110.3 million on 30 March 1999. Also in March 1999 Mirror Group disposed of its former head office building in Holborn for £40 million (£31 million net of financing).

3.25. Mirror Group told us that the proceeds from the sale of SMG and the Holborn site would enable the group to reduce borrowings and release resources to pursue the group strategy to:

— continue to invest in the rejuvenation of Mirror Group's national and Scottish titles;

— develop further the group's market-leading regional positions through organic growth and acquisition; and

— invest in high growth areas, particularly areas involving the Internet.

Financial performance of Mirror Group

3.26. Profit and loss accounts, balance sheets and cash flow statements for Mirror Group for each of the past five financial years are set out in Appendices 3.2, 3.3 and 3.4 respectively. Some of the more significant figures derived from those appendices are extracted and analysed in Table 3.1.

TABLE 3.1 **Mirror Group: summary financials, 1994 to 1998**

£ million

	*Years ended 31 December**				
	1994	*1995*	*1996*	*1997*	*1998*
Profit and loss					
Turnover	463	512	538	559	697
Gross profit	197	193	202	219	296
Trading profit	116	107	99	111	130
Net profit before tax	189†	107	102	80	100
Net profit after tax	145†	83	83	57	67
Cash flows					
Net operating cash flow	99	110	120	136	182
Free cash flow	26	68	63	73	101
Balance sheet					
Intangible assets‡	0	0	0	185	205
Tangible fixed assets	364	361	353	371	360
Net operating assets	322	304	315	501	485
Net debt	(383)	(309)	(291)	(522)	(489)
Shareholders' funds‡	(31)	(17)	38	(40)	28
Capital invested§	(16)	51	117	219	263
					per cent
Performance ratios					
Return on sales¶	25.1	20.8	18.4	19.8	18.7
Return on average net operating assets ¶	33.8	34.1	32.1	27.1	26.4
Return on average capital invested ¶	N/A	596.1	117.7	65.9	54.1
Net debt divided by net debt plus capital invested	N/A	86.0	71.6	70.7	65.2
					times
Interest cover ¶	4.2	4.0	5.7	4.3	3.4

Source: Mirror Group.

*Mirror Group's financial year runs for 52 or 53 weeks (and hence not precisely to 31 December).

†1994 profits include an extraordinary profit before tax of £111 million relating to the reduction in the provision to meet the obligations of the Past Service Pension Scheme.

‡For consistency with 1998 we have written off £625 million of intangibles in 1994 to 1997 (see paragraph 3.30).

§Capital invested represents shareholders' funds adjusted to add back goodwill written off and to eliminate asset revaluation surpluses.

¶Based on trading profit (operating profit before exceptional items).

3.27. Group turnover increased from £463 million in 1994 to £697 million in 1998 (compound annual growth rate of 10.8 per cent) and group trading profit increased from £116 million to £130 million over the same period (compound annual growth rate of 2.9 per cent). The largest factor contributing to this growth was the acquisition of MIN in November 1997. In fact, between 1994 and 1996 group trading profit fell by 14.5 per cent as a result of cover price cutting by *The Sun* and *The Times*, which was not reciprocated by Mirror Group, a sharp rise in the cost of newsprint and start-up losses on Live TV. Similarly, return on sales fell from 25.1 per cent in 1994 to 18.4 per cent in 1996. Return on sales increased to 19.8 per cent in 1997 as a result of gains in efficiency and the fall in average newsprint prices but fell in 1998 to 18.7 per cent, largely due to the increased investment in the national titles (see paragraph 3.37).

3.28. Included in arriving at the trading profit of the group of £130 million in 1998 is a loss of about £9 million from Live TV. Mirror Group is budgeting for these losses to fall to £4 million in 1999 and for the division to break even in 2000 (based on an increase in subscriber numbers to 3.3 million). In 1998 the investment in SMG contributed about £9 million to operating profits (not included in the group trading profits of £130 million).

3.29. Mirror Group has exhibited a strong increase in net operating cash flows over the five-year period, growing from £99 million in 1994 to £182 million in 1998. The particularly large increase in net operating cash flows from £136 million in 1997 to £182 million in 1998 reflects the full-year cash flow contribution of the MIN acquisition. The cash flows for the period and net debt position at the year end

also benefit from Mirror Group's concentration on the collection of debtors prior to the year end (herein referred to as the 'cash push').

3.30. In accordance with the recent accounting standard FRS10, Mirror Group has eliminated the £625 million valuation of internally generated intangibles (being the directors' valuation of the pre-existing brand values for the national and Scottish titles) from the balance sheet in the 1998 accounts. The remaining balance of intangible assets relates to the brand values recognized on acquisition of the MIN titles (£180 million), the Century titles (£6 million), the Derry Journal Limited titles (£13 million) and goodwill (£6 million). For consistency, we have made the same adjustment to the comparative figures for 1994 to 1997 as set out in Table 3.1 and Appendix 3.3. The elimination of the internally generated intangibles over the period results in negative or negligible net assets (£28 million in 1998), reducing the value of conventional gearing calculations.

3.31. An alternative measure of financial gearing is calculated as net debt divided by net debt plus capital invested. On this measure, the gearing of Mirror Group has fallen from 86 per cent in 1995 to 65 per cent in 1998. Arguably a better measure of the extent of financial obligations of the group is interest cover (trading profit as a multiple of net interest expense). Interest cover has fallen from 5.7 times in 1996 to 3.4 times in 1998, largely as a result of the MIN and other acquisitions.

3.32. A breakdown of the different sources of turnover within Mirror Group's newspaper business from 1996 to 1998 is given in Table 3.2.

TABLE 3.2 **Mirror Group: analysis of turnover from newspaper activities, 1996 to 1998**

	*Years ended 31 December**					
	1996		*1997*		*1998*	
	£m	*%*	*£m*	*%*	*£m*	*%*
Display	160		169		199	
Classified	32		44		98	
Total advertising revenue	192	*38*	213	*41*	297	*46*
Circulation revenue	309	*61*	300	*58*	334	*51*
Other	5	*1*	6	*1*	31	*3*
Total newspaper revenue	506	*100*	519	*100*	662	*100*
Non-newspaper revenue	32		40		35	
Total group turnover	538		559		697	

Source: Mirror Group.

*Mirror Group's financial year runs for 52 or 53 weeks (and hence not precisely to 31 December).

3.33. In 1998 circulation revenue accounted for 51 per cent of the group's UK newspaper revenue. Prior to the acquisition of MIN, circulation revenue accounted for about 61 per cent of newspaper revenue. The majority of revenue growth in recent years has come from advertising revenues, which have increased from £192 million in 1996 to £297 million in 1998 as a result of the acquisition of MIN and a buoyant advertising market.

3.34. The increase in the proportion of advertising represented by classified advertising is a result of the acquisition of MIN's regional newspapers. Table 3.3 sets out the different components of the turnover earned by the national, Scottish and regional newspaper publications of Mirror Group in 1998.

TABLE 3.3 **Components of newspaper turnover by major division, 1998**

	National	Scottish	Regional
	% of total revenue		
Circulation	60	55	19
Advertising	38	44	74
Other	2	1	7
Total	100	100	100
	% of advertising revenue		
Classified	12	33	66
Display	88	67	34
	100	100	100

Source: Mirror Group.

3.35. The majority of revenue for the national titles is generated by circulation (60 per cent) whereas for the regional titles the largest contributor to revenue is advertising (74 per cent). Of the advertising revenues earned by the national titles, 88 per cent represents display advertising, in contrast to the regional titles with 34 per cent (66 per cent comes from classified advertisements).

3.36. Table 3.4 sets out the contribution to turnover and profitability of each division making up the newspaper activities of Mirror Group.

TABLE 3.4 **Mirror Group: newspaper turnover and profitability by division, 1998**

	Turnover		Trading profit		Return on sales
	£m	%	£m	%	%
National	397	60	70	52	18
Scottish	110	17	27	20	25
Other regional	132	20	34	26	26
Sports	23	3	3	2	13
Total	662	100	134	100	20

Source: Mirror Group.

3.37. The greatest contributor to Mirror Group's newspaper turnover and profits in 1998 was the national newspaper division with £397 million in turnover (60 per cent of the group's newspaper business) and £70 million in trading profit (52 per cent of the group's newspaper business). In 1998, of the national titles, *The Mirror* alone contributed £[✂] million to turnover and £[✂] million to trading profit. As a comparison, the turnover and trading profit for the national titles in 1997 were £405 million and £88 million respectively. Both turnover and trading profit from national newspapers fell from 1997 to 1998, trading profit by about £18 million (a fall in the return on sales from 22 to 18 per cent). This fall in profitability is largely a result of the rejuvenation plan implemented by Mirror Group aimed at reducing the circulation decline of its national titles. Mirror Group estimated that in 1998 an additional £13 million was invested in *The Mirror* alone. This investment included costs related to the production of additional supplements (£6 million on *The Look*), improvements in editorial content and a general increase in size of the newspapers. To a large extent, Mirror Group funded this investment from the growth in the underlying profitability of the regional newspapers acquired from MIN and the synergies obtained by combining the MIN business with the rest of Mirror Group (estimated by management to be between £6 million and £8 million in 1998).

3.38. Mirror Group told us that since the time of the management restructuring of Mirror Group in September 1992, Mirror Group has been a net creator of full-time jobs for journalists working on the national titles (increased from 358 in September 1993 to 410 in March 1999).

Trinity

3.39. Trinity is an independent publisher of regional and local newspapers and advertising media. It is incorporated in the UK and listed on the London Stock Exchange. At 28 May 1999 its market capitalization was £799 million.

3.40. The company has its origins in the mid-19th century, when the *Daily Post*, a penny daily newspaper, was established in Liverpool. In 1879 the *Liverpool Echo*, an evening newspaper that served the Merseyside area, was first published by the same owner. The Liverpool Daily Post and Echo plc (later to change its name to Trinity) was incorporated in 1904. In 1957 Trinity took the first step in widening its interests by acquiring the Birkenhead News Group and, shortly afterwards, Stephenson Newspapers Limited of Southport, both publishers of weekly newspapers.

3.41. In 1958 Trinity entered the Canadian regional newspaper market and in 1978 made its first acquisition in the USA. A further diversification of Trinity's interests began in 1961 with investments in paper-making and corrugated board and case manufacturing. In 1988 Trinity began the next stage of its development in the UK with the acquisition of North Wales Independent Press Ltd, a group of newspapers serving virtually all the communities in North Wales from its headquarters in Llandudno. At the end of 1991 Trinity acquired the free newspaper publisher known as Merseymart, which operated in Liverpool.

3.42. In recent years Trinity has undergone significant changes, divesting itself of its non-publishing interests and its North American publishing interests and expanding its UK publishing business through organic growth and acquisition. Following the disposal of its paper-making and packaging interests in 1992, Trinity made a number of significant acquisitions in the regional newspaper industry in the UK, including:

— Scottish and Universal Newspapers Ltd (the largest weekly newspaper group in Scotland) in July 1992;

— Joseph Woodhead & Sons Limited (publisher of the Huddersfield Newspaper Group of regional and local daily and weekly titles including the *Huddersfield Daily Examiner*) in November 1993;

— a portfolio of weekly newspaper titles in the South-East of England from Argus Press Limited also in November 1993; and

— the newspapers published by Thomson Regional Newspapers Limited (Thomson) from its regional centres in Belfast, Cardiff, Chester, Newcastle-upon-Tyne and Teesside, in January 1996.

3.43. Trinity has also made a number of smaller and non-newspaper acquisitions including:

— Micromart (UK) Limited, a Midlands-based publisher of a weekly buy-and-sell computer magazine, *Micro Computer Mart*, in February 1995;

— some A4 newsprint-based consumer interest products (primarily monthly) from Aceville Publications Limited, in May 1997;

— Sunday *Business Post*, a quality Sunday business newspaper based in Dublin, in August 1997;

— a computer trade magazine from IT Trade Publishing Limited in October 1997;

— *East End Independent* in Glasgow from the Holdstock family in March 1998; and

— *AMRA* national sales house in November 1998, providing a platform from which to develop national advertising.

3.44. In May 1998 at the Annual General Meeting it was agreed to change the company's name from Trinity International Holdings plc to Trinity plc. Trinity is the third largest publisher of regional and local newspapers in the UK (on the basis that the *Daily Record*, *Sunday Mail*, *Sunday Post* and *Evening Standard* are classified as regional newspapers). Its major titles are published in six daily centres: Belfast, Cardiff, Huddersfield, Liverpool, Newcastle and Teesside. Trinity publishes 10 daily (4 morning and 6 evening), 3 Sunday, 3 paid-for bi-weekly, 48 paid-for weekly, 57 free weekly and 5 free monthly titles. A full list of Trinity's Northern Ireland and Scotland titles and daily and Sunday titles in England and Wales is set out in Appendix 3.5. In addition, Trinity publishes a portfolio of general interest and employment magazines and free, advertisement-only, publications.

3.45. In recent years, Trinity has established itself as a leading regional publisher on the Internet (registering more than 4 million page impressions per month in 1998) with most of its major titles having their own web site. Trinity is continuing its development in this activity in partnership with other regional publishers (partnerships include *ADHunter* (in which RIM also has an interest—see paragraph 3.64) for classified advertising and *Quartet* for directory information).

3.46. Trinity also holds a 50 per cent interest (the other 50 per cent is held by DMGT) in the local cable television broadcasting company, Channel One Liverpool Limited. Trinity has informed us that [*Details omitted. See note on page iv.*] Trinity has accounted for this as an associated company. In addition, Trinity has a 20 per cent shareholding in the independent radio broadcaster Independent Radio Group plc, but does not account for this as an associated company as the group does not exercise significant influence over the company.

3.47. Trinity's head office is in Chester. The average number of employees (full-time equivalent) in 1998 was 5,944. Trinity's main shareholders are financial institutions, the largest of which (Capital Group Companies Inc) holds 6.5 per cent and the second largest of which (Standard Life Assurance Co) holds 4.7 per cent.

Financial performance of Trinity

3.48. Profit and loss accounts, balance sheets and cash flow statements for Trinity for each of the past five financial years are set out in Appendices 3.6, 3.7 and 3.8 respectively. Some of the more significant figures derived from these appendices are extracted and analysed in Table 3.5.

3.49. Group turnover has increased from £164 million in 1994 to £342 million in 1998 (compound annual growth of 20.1 per cent) and group trading profit has increased from £26 million to £81 million over the same period (compound annual growth of 33.5 per cent). The largest factor contributing to this growth was the acquisition of Thomson in early 1996, which roughly doubled the size of the group. Net operating cash flows have also increased substantially from £27 million in 1994 to £91 million in 1998.

3.50. The group disposed of its Canadian operations in late 1996 (which resulted in a fall in group turnover in 1997) and disposed of its US operations during 1998. For this reason we have analysed separately the continuing activities of the group. The turnover from continuing activities increased from £109 million in 1994 to £321 million in 1998 (compound annual growth of 31.0 per cent) and the trading profit increased from £21 million to £78 million over the same period (compound annual growth of 39.6 per cent). Since 1996, the year of the Thomson acquisition, the compound growth in turnover and trading profit from continuing activities has been 8.0 per cent and 16.7 per cent respectively.

3.51. The return on sales from continuing activities has increased from 18.8 per cent in 1994 to 24.2 per cent in 1998. Recent improvements in the return on sales are a result of a combination of factors including the strength of the UK economy (resulting in strong increases in advertising volume and revenue) and the cost savings resulting from merging the operations of Thomson with those of Trinity.

TABLE 3.5 **Trinity: summary financials, 1994 to 1998**

£ million

	*Years ended 31 December**				
	1994	*1995*	*1996*	*1997*	*1998*
Profit and loss					
Turnover:					
Continuing	109	113	276	300	321
Discontinued (USA and Canada)	55	55	57	25	21
	164	168	333	325	342
Gross profit	77	76	158	165	177
Trading profit:					
Continuing	21	22	57	70	78
Discontinued (USA and Canada)	5	5	6	4	3
	26	27	63	74	81
Net profit before tax	23	27	56	64	84†
Net profit after tax	16	18	39	44	63
Cash flows					
Net operating cash flow	27	21	76	82	91
Free cash flow	13	5	45	47	40
Balance sheet					
Intangible assets	79	84	349	354	349
Tangible fixed assets	52	57	115	118	123
Net operating assets	138	149	487	463	462
Net cash/(debt)	(38)	139	(159)	(118)	(66)
Shareholders' funds	96	289	315	330	380
Capital invested‡	113	306	329	356	400
					per cent
Performance ratios					
Return on sales—continuing§	18.8	19.8	20.8	23.4	24.2
Return on sales—total§	15.5	16.4	18.9	22.8	23.7
Return on average net operating assets§	18.5	19.2	19.8	15.6	17.5
Return on average capital invested§	23.5	N/A¶	19.8	21.6	21.4
Net debt as a percentage of shareholders' funds	40.0	N/A¶	50.5	35.6	17.3
Net debt divided by net debt plus capital invested	25.4	N/A¶	32.6	24.8	14.1
					times
Interest cover§¤	9.6	N/A¶	4.8	7.1	9.6

Source: Trinity.

*Trinity's financial year runs for 52 or 53 weeks (and hence not precisely to 31 December).

†1998 profits include an extraordinary profit of £17.6 million on the disposal of the group's US operations.

‡Capital invested represents shareholders' funds adjusted to add back goodwill written off and to eliminate asset revaluation surpluses.

§Based on trading profit (operating profit before exceptional items).

¶See paragraph 3.54.

¤1998 net interest expense excludes non-recurring items of about £2.1 million.

3.52. The largest component of the net operating assets of the group is the value of acquired intangible assets which rose from £84 million at 30 December 1995 to £349 million at 29 December 1996 as a result of the Thomson acquisition.

3.53. At 29 December 1996, post-acquisition of Thomson, Trinity had gearing of 50.5 per cent and an interest cover ratio for the year then ended of 4.8 times. Since then, Trinity has been able to reduce substantially this level of gearing (to 17.3 per cent at 27 December 1998) and increase interest cover (to 9.6 times for the year ended 27 December 1998) by applying both surplus cash generated by the business and the cash received from the sale of its Canadian and US operations to reduce the level of borrowings.

3.54. The return on capital invested, gearing and interest cover ratios for 1995 are not comparable due to the net cash position at 30 December 1995 resulting from the proceeds of the rights issue received in advance of the Thomson acquisition in the following financial period.

3.55. A breakdown of the different sources of turnover within Trinity's UK newspaper business from 1996 to 1998 is set out in Table 3.6.

TABLE 3.6 **Trinity: analysis of turnover from newspaper activities, 1996 to 1998**

	*Years ended 31 December**					
	1996		*1997*		*1998*	
	£m	*%*	*£m*	*%*	*£m*	*%*
Display	65		70		72	
Recruitment	38		48		54	
Property	19		20		22	
Motors	25		27		29	
Other	41		42		43	
Bad debts and allowances	(3)		(3)		(3)	
Total advertising revenue	185	*67*	204	*69*	217	*70*
Circulation revenue	64	*23*	64	*22*	64	*21*
Printing revenue	15	*5*	12	*4*	12	*4*
Inserts	4	*2*	5	*2*	5	*2*
Other	8	*3*	8	*3*	10	*3*
Total newspaper revenue	276	*100*	293	*100*	308	*100*
Non-newspaper revenue (including discontinued)	57		32		34	
Total group turnover	333		325		342	

Source: Trinity.

*Trinity's financial year runs for 52 or 53 weeks (and hence not precisely to 31 December).

3.56. In 1998 about 70 per cent of Trinity's newspaper revenues came from advertising and the growth in total newspaper revenue in recent years has largely resulted from growth in advertising revenue (increased by 10.2 per cent in 1997 and by 6.1 per cent in 1998) with circulation revenue remaining steady. In 1998 two-thirds of advertising revenue came from classified advertising. Within classified advertising, recruitment advertising has shown the strongest growth in recent years, increasing from £38 million in 1996 to £54 million in 1998.

3.57. The performance of each of Trinity's regional centres for the year ended 27 December 1998 is given in Table 3.7.

TABLE 3.7 **Trinity: analysis of regional performance, 1998**

	Turnover £m	*Trading profit £m*	*Return on sales %*
Belfast			
Newcastle			
Teesside			
Scotland		*Figures omitted. See note on page iv.*	
Merseyside			
Huddersfield			
Chester			
Cardiff			
Trinity Southern			
Total	308.4	75.2	24.4

Source: Trinity.

3.58. Trinity has a geographically diverse portfolio of regional newspaper interests with revenues and profits spread across each of its centres. In 1998 the Belfast centre generated a return on sales of

[*Details omitted. See note on page iv.*] higher than the group average of 24.4 per cent. The Belfast centre's higher margins are a result of a combination of factors including:

- the fact that the Belfast centre publishes a large regional evening newspaper without a morning newspaper or a significant number of weekly titles (which operate to reduce the margins in other centres);
- the high utilization of print presses and substantial contract printing activities; and
- low depreciation charges.

RIM

3.59. RIM was incorporated in February 1998 as the vehicle for the investor-led acquisition of the regional newspapers and related businesses of UPN, which was formerly part of UNM, for £360 million. The acquisition was led and arranged by Candover, with support from investment affiliates of the Goldman Sachs Group Inc (Goldman Sachs), and a Dutch Venture Capital Group, Alpinvest Holding NV (Alpinvest).

3.60. Candover, and funds managed by it, are the principal shareholders of RIM, with an interest of 45.4 per cent. Investment affiliates of Goldman Sachs own 27.2 per cent, with the remaining 27.4 per cent held by Alpinvest (18.2 per cent) and RIM management (9.2 per cent).

3.61. The history of the RIM portfolio of titles goes back to the publication of the *Leeds Intelligencer*, the predecessor of the *Yorkshire Post* in 1754. In 1866 the Yorkshire Conservative Newspaper Company Limited was established, which launched both the *Yorkshire Post* and the *Yorkshire Evening Post*. This business developed through organic growth and some acquisitions until the merger with United Newspapers in 1969, which subsequently merged with MAI plc to form UNM in 1996.

3.62. RIM is the sixth largest publisher of regional and local newspapers in the UK. It operates from nine publishing centres: Leeds, Sheffield, Harrogate and Dewsbury (all in Yorkshire) and Preston, Blackpool, Wigan, Burnley and Lancaster & Morecombe (all in the North-West). In Yorkshire, RIM's major titles are *Yorkshire Post*, *Yorkshire Evening Post* (both published in Leeds) and *The Star* (published in Sheffield). In the North-West, its major titles are *Lancashire Evening Post* (published in Preston) and *The Gazette* (published in Blackpool). RIM publishes 9 daily (1 morning and 8 evening), 2 paid-for bi-weekly, 33 paid-for weekly, 16 free weekly, 1 paid-for monthly and 3 free monthly titles. A full list of RIM's titles is set out in Appendix 3.9.

3.63. RIM's head office is in Leeds. The average number of employees in 1998 was 2,474 full-time and 855 part-time. The senior management of RIM, Chris Oakley (Chief Executive), Ernest Petrie (Group Managing Director) and Sir Norman Fowler (Chairman), held similar positions at MIN prior to its purchase by Mirror Group in 1997. A director of Candover, Mr Colin Buffin, is represented on the board of RIM. Mr Buffin was previously a director of MIN, a former investment of Candover. Goldman Sachs is represented on the board by Mr Hughes Lepic and Alpinvest by Mr Jaap Vermeulen.

3.64. RIM has developed a new media programme to concentrate on areas such as Internet web sites and on-line services. To date, RIM has launched 15 Internet web sites and has an 11.5 per cent shareholding in *ADHunter*, a joint venture company that operates a classified advertising Internet operation.

3.65. RIM has a portfolio of magazines and specialist titles, which are published from the nine publishing centres and a direct marketing division, involved in delivering leaflets in areas in which RIM's titles are delivered. RIM also operates premium rate telephone services.

3.66. RIM has printing facilities at sites in Leeds, Sheffield, Harrogate and Wigan, with the majority of its Yorkshire titles being printed in-house at Leeds, Sheffield or Harrogate. RIM has a 15-year agreement (expiring in February 2013) with Broughton Printers Limited (Broughton), a

subsidiary of UNM, for all its printing requirements in the North-West (excluding contract printing). During the course of 1998 and early 1999 the printing of the majority of RIM's north-west titles was transferred from the RIM site at Wigan to Broughton. The only RIM publications that are still printed at the Wigan site are *The Rugby Leaguer* and *Steam Railway News*. Most of the capacity at the Wigan site is now used for contract printing. Leeds, Sheffield and Harrogate also carry out contract printing. The group carries out contract printing for a number of third parties including the following titles: *The Observer*, *Financial Times*, *The Express*, *The Express on Sunday* and *The Daily Star*.

Funding of the acquisition of UPN by RIM

3.67. The purchase cost of the UPN acquisition in February 1998 of £376 million (including costs) was financed through:

— senior bank debt of £150 million loans;

— mezzanine debt of £115 million (repaid in June 1998 by an issue of US$110 million (value on maturity) senior notes and £93.5 million (value on maturity) senior discount notes);

— equity of £111 million; and

— £25 million of revolving credit facilities (available for general corporate purposes and not used to date).

3.68. The equity in RIM is held in the form of ordinary shares and subordinated loan stock. The subordinated loan stock (value of £115.6 million at 31 December 1998) is a tax-efficient equity instrument which pays no current interest (interest is rolled up into the principal) and is redeemable on exit. It ranks beneath all other debt instruments and is unsecured. Accordingly, although it is classified as debt in the accounts of RIM, it is treated by investors as the equivalent of an equity instrument.

3.69. The consolidated balance sheet for RIM at 31 December 1998 is set out in Table 3.8.

TABLE 3.8 **RIM balance sheet, 31 December 1998**

	£m
Fixed assets	
Intangible assets:	
Publishing rights and titles	270.7
Goodwill	30.9
Tangible assets	66.1
	367.7
Current assets	
Stocks	1.1
Debtors	21.7
	22.8
Creditors: amounts falling due within one year	(18.3)
Net operating assets	372.2
Investments	0.1
Net cash/(debt)*	(370.2)
Provisions	(8.2)
Net assets	(6.1)
Capital and reserves	
Share capital and premium	5.1
Reserves	(11.2)
Shareholders' funds	(6.1)
Capital invested (including loan stock as equity)	109.5

Source: RIM.

*Includes loan stock of £115.6 million. If this loan stock is classified as equity, net debt is £254.6 million.

3.70. RIM told us that its highly-geared capital structure is typical for a leveraged buyout. If the institutional loan stock is classified as equity, the gearing of RIM at 31 December 1998 would be 232.5 per cent (see Table 3.9). Candover told us that in its view, and in the view of the market more generally, the appropriate level of gearing and interest cover for a business depended on its cash flow and that where cash flows were stable, which was the case with newspaper businesses, a higher level of debt and a lower level of interest cover was usually appropriate. Candover had satisfied itself that if RIM acquired Mirror Group there would be sufficient capital to invest in the company and allow it to grow.

Financial performance of RIM

3.71. The profit and loss account for RIM for the ten-month period from 27 February 1998 to 31 December 1998, the first period for which consolidated accounts have been published, is set out in Appendix 3.10. For comparative purposes, RIM also included in its 1998 accounts unaudited pro forma combined figures for the two years ended 31 December 1998. These were prepared by consolidating the prior period results of operations acquired by the group in a manner consistent with the group's accounting policies. Some of the more significant figures are extracted and analysed in Table 3.9.

TABLE 3.9 **RIM: summary financials, 1997 and 1998**

			£ million
	Unaudited pro forma		*Actual*
	Years ended 31 December		
	1997	*1998*	*27.2.98 to 31.12.98*
Profit and loss			
Turnover	141.2	147.3	121.5
Trading profit	25.7	31.4	27.3
Net profit/(loss) before tax	N/A	N/A	(11.8)
Net profit/(loss) after tax	N/A	N/A	(11.2)
			per cent
Performance ratios			
Return on sales*	18.2	21.3	22.5
Trading profit as a percentage of net operating assets*	N/A	8.4	N/A
Trading profit as a percentage of capital invested*†	N/A	28.7	N/A
Net debt as a percentage of shareholders' funds‡	N/A	232.5	N/A
Net debt divided by net debt plus capital invested†	N/A	69.9	N/A
			times
Interest cover*	N/A	0.9	N/A

Source: RIM.

*Based on trading profit (before amortization of goodwill and exceptional items).

†Capital invested represents shareholders' equity adjusted to include loan stock as equity.

‡For the purposes of the gearing calculation, shareholders' funds and net debt are adjusted to reflect the loan stock as equity.

3.72. On the basis of the pro forma combined figures for the businesses acquired by RIM, turnover increased from £141.2 million in 1997 to £147.3 million in 1998. Trading profit increased from £25.7 million to £31.4 million over the same period resulting in an increase in return on sales from 18.2 to 21.3 per cent.

3.73. These increases in profitability are due to strong growth in classified advertising revenues (particularly recruitment), the benefits resulting from management's implementation of a cost reduction programme and restructuring of the group since acquisition.

3.74. For the period of ownership from 27 February 1998 to 31 December 1998 RIM generated a net loss after tax of £11.2 million. However, in the same period, the business generated free cash flows of £3.7 million (see Table 3.10). The large difference between profitability and cash flow is caused by the element of capitalized interest (ie interest expensed but not paid). Capitalized interest for the period amounted to £9.1 million in relation to the loan stock and £3.4 million in relation to the senior discounted notes. The difference between interest expense of £36.2 million and net financing costs (including interest paid and issue costs) of £25.1 million in 1998 is £11.1 million.

3.75. Table 3.10 illustrates the cash flow statement of RIM for the period from 27 February 1998 to 31 December 1998.

TABLE 3.10 **RIM cash flow statement, ten-month period from 27 February 1998 to 31 December 1998**

	£m
Trading profit	27.3
Add back depreciation	6.0
Movement in working capital	5.3
Other	(1.6)
Net operating cash flow	37.0
Net financing costs	(25.1)
Capital expenditure and financial investment	(8.2)
Free cash flow	3.7
Acquisitions and disposals	(373.5)
Net (increase)/decrease in net financing	(369.8)

Source: RIM.

3.76. A breakdown of the different sources of turnover within the newspaper businesses acquired by RIM for the two years ended 31 December 1998 is set out in Table 3.11.

TABLE 3.11 **RIM: analysis of turnover from newspaper activities, 1997 and 1998**

	Years ended 31 December			
	1997		*1998*	
	£m	*%*	*£m*	*%*
Display	35.0		35.2	
Recruitment	25.4		28.9	
Property	10.0		10.8	
Motors	12.3		13.1	
Other	16.3		15.8	
Allowances	(1.8)		(1.5)	
Total advertising revenue	97.2	*69*	102.3	*70*
Circulation revenue	28.6	*20*	28.2	*19*
External printing revenue	8.3	*6*	9.0	*6*
Other	7.1	*5*	7.8	*5*
Total revenue	141.2	*100*	147.3	*100*

Source: RIM.

3.77. Whilst gross display advertising revenue increased only marginally from £35.0 million in 1997 to £35.2 million in 1998, classified advertising revenue increased by 7.2 per cent from £64.0 million to £68.6 million over the same period (particularly as a result of strong recruitment advertising revenues which grew by 13.8 per cent and represented 19.6 per cent of RIM's total revenue in 1998).

Current and prospective shareholders of RIM

3.78. Paragraph 3.60 provides details of the current shareholdings of Candover, Goldman Sachs and Alpinvest. As discussed in paragraph 3.106, RIM told us that these existing shareholders (in the case of Goldman Sachs the successor investment affiliates of the current investors) together with Morgan Grenfell Private Equity and Soros Private Equity are expected to provide the equity for the acquisition of Mirror Group. The following section provides a description of the activities and history as private equity investors of each of these existing and prospective shareholders of RIM.

Candover

3.79. Candover is one of the leading organizers of, and investors in, large management and institutional buyouts and buyins in the UK and Continental Western Europe. Candover was incorporated as a private company in 1980 and reregistered as a public limited company and listed on the London Stock Exchange in 1984. For the year ended 31 December 1998, Candover had an average of 28 staff.

3.80. Candover's profit before tax for the year ended 31 December 1998 was £12.1 million and its market capitalization at 28 May 1999 was about £214 million. Candover has about £200 million in net assets, but this represents a small portion of the funds under management of over £1 billion.

3.81. The major shareholders of Candover are made up of other investment trusts and institutional investors. The largest of these at 8 March 1999 were Schroder Investment Management Limited with 12.6 per cent, Electra Investment Trust plc with 8.8 per cent and The Scottish Eastern Investment Trust plc with 8.3 per cent. Directors own about 6.3 per cent of the issued share capital.

3.82. The largest current investments of the group include Crown Castle International Corp, Newmond plc, RIM, Camden Motors Limited and Shepperton Holdings Limited.

3.83. Candover makes its investments either under a co-investment agreement with third party managed funds or on its own account. The third party managed funds, established with commitments from a wide range of international institutional investors, are managed by subsidiaries, Candover Partners Limited and Candover Services Limited. Candover participates in the profit made in certain of these funds subject to an overall minimum return having first been generated for third party investors.

3.84. Candover's most recent fund, the Candover 1997 Fund, has total third party commitments (from 56 individual subscribers) amounting to £750 million together with a further £100 million provided by Candover under a co-investment agreement. The Candover 1997 Fund has made four investments to date, drawing down a total of £139.9 million. It is intended that the funds invested by Candover in the proposed acquisition of Mirror Group will be provided by the Candover 1997 Fund and Candover under its co-investment agreement.

3.85. A key business issue at Candover is the identification and evaluation of its investments. An investment report is prepared for each potential investment after undertaking a comprehensive study. In the case of an investment by one of the managed funds, the investment report is sent to the board of Candover Partners Limited for their decision as to whether or not to proceed. In the case of other investments the report is sent to the board of Candover plc.

3.86. Candover told us that it has a strong relationship with its major shareholders but its shareholders play no role and have no influence in relation to approving investments made by any of the Candover funds. The limited partners of the Candover 1997 Fund are precluded from active participation in making investment decisions. All investment decisions in relation to the Candover 1997 Fund are made by the general partner, Candover Partners Limited, a subsidiary of Candover.

Goldman Sachs

3.87. Goldman Sachs is a leading worldwide investment bank with long experience as intermediary and adviser in the world's financial markets. Goldman Sachs was listed on the New York Stock Exchange in May 1999. Goldman Sachs began to commit its partners' capital to long-term investment opportunities in 1983 and has since invested in excess of US$5.1 billion in approximately 203 companies through investment partnerships in which affiliates of Goldman Sachs act as general partner, managing general partner or managing partner. The current principal vehicle for these investments is GS Capital Partners III LP and its offshore affiliates, a fund set up in 1998 with committed capital of more than US$2.775 billion. Within the past five years, the firm has invested more than US$702 million of equity in 19 transactions in Europe. The firm has more than 60 professionals dedicated to this business, based at offices in New York, London, Singapore and Hong Kong.

Alpinvest

3.88. Alpinvest is an independent private equity investor, which was listed on the Amsterdam Stock Exchange in June 1997. Alpinvest provides private equity and venture capital to unlisted, medium-sized companies and is one of the largest private equity investors in the Netherlands. It has almost 20 years' experience in equity financing and is involved in approximately 300 private equity transactions per year. Alpinvest's management consists of four experienced professionals led by Mr Stan Vermeulen (Chief Executive Officer since 1993).

Morgan Grenfell Private Equity

3.89. Morgan Grenfell Private Equity (MGPE), a wholly-owned subsidiary of Deutsche Bank, was founded in 1989 and since that time has been one of the major private equity investment firms in Europe. MGPE has a professional staff of 22 with offices in London, Frankfurt and Milan. Over the past nine years, MGPE has invested more than US$1 billion in 44 companies. Deutsche Bank, MGPE's ultimate parent, is one of the world's largest financial institutions with total assets exceeding DM1.2 trillion. MGPE is in the process of raising a new pan-European fund to continue the principal investment strategies of the three existing 1995 pools aggregating US$771 million. In 1998 MGPE invested in four investor-led transactions in the UK with an approximate combined value of £649 million.

Soros Private Equity Partners

3.90. Soros Private Equity Partners LLC (SPEP) is an affiliate of Soros Fund Management LLC, the private investment management firm founded by George Soros. Soros Fund Management LLC advises the Quantum Group of Funds, a group of investment funds with assets under management of about US$17 billion. SPEP is responsible for making direct private equity investments on behalf of Quantum Industrial Holdings Ltd, a US$3.5 billion investment fund, and certain other affiliates of the Quantum Group of Funds. Quantum Industrial Holdings Ltd is an open-ended investment fund formed in 1994 to allow stockholders of the Quantum Group of Funds to participate in an investment programme emphasizing strategic investments. SPEP has 12 investment professionals located in New York and London. Since August 1998 SPEP has committed roughly US$250 million in capital across a range of investments.

Funding of the acquisition

Trinity's proposed offer for Mirror Group

3.91. No formal offer has been made by Trinity to acquire Mirror Group. However, the company made a proposed offer on 26 February 1999 on the basis of 0.35 new Trinity shares and 40p in cash for each existing Mirror Group share. As a result of the structure of those terms, the value of Trinity's proposed offer is dependent upon Trinity's share price. Based on Trinity's share price of 495p at the

close of trading on 1 March 1999, the date upon which Mirror Group rejected the terms, the terms valued each Mirror Group share at 213.25p and Mirror Group at £973 million. After adding back net debt at 31 December 1998 of £489 million, the proposed offer implied a total enterprise value of £1,462 million. An offer on these terms would leave existing Mirror Group shareholders with about 53 per cent of the share capital of the merged group.

3.92. Since Trinity announced its proposed offer to acquire Mirror Group, Mirror Group has sold its interest in SMG for £110.3 million and its former head office building in Holborn for £31 million net of financing (see paragraph 3.24). The proceeds from the disposals will result in a corresponding fall in the net borrowings of Mirror Group, giving pro forma year-end debt of about £348 million. The effect of the disposals on the existing financial position and ongoing profitability of Mirror Group may influence Trinity's assessment of the terms of any proposed acquisition of Mirror Group. However, Mirror Group expected that the disposals would be cash-flow enhancing as the dividends forgone on the SMG shares will be more than compensated for by interest savings. On this basis, we do not believe the sales would have a material impact on Trinity's assessment of the transaction and for our purposes believe it is still appropriate to analyse the terms of the proposed offer.

3.93. Trinity's share price on 28 May 1999 was 574p representing a market capitalization of £799 million. As at 27 December 1998 Trinity had net debt of £66 million, giving a total enterprise value of £865 million. At this share price, Trinity is trading on a multiple of 2.7 times 1998 continuing turnover of £321 million and 11.1 times 1998 continuing trading profit of £78 million, before exceptional items.

3.94. At a share price of 574p per share, Trinity's proposed offer terms value each Mirror Group share at 241p, giving a market capitalization for Mirror Group of £1,100 million and a total enterprise value of £1,448 million, taking account of the two disposals referred to in paragraph 3.92. At this level, the proposed offer represents a multiple of 2.1 times 1998 turnover of £697 million and 11.1 times 1998 trading profit of £130 million, before exceptional items.

3.95. The share price of Mirror Group at 31 December 1998, prior to any proposed offers being made for the company, was 150p. Trinity's proposed offer, based on a Trinity share price of 574p, represents a 61 per cent premium to this price.

3.96. Trinity's proposed offer includes 40p in cash per share, which results in £183 million of cash being required for the proposed offer. On a pro forma basis the combined group would have net debt of around £597 million, being the year-end debt of each company adjusted for the cash element and disposals, but before any costs associated with the transaction.

3.97. Trinity has provided a financial model, which also takes account of a number of other factors, which increase the level of debt. These factors include the costs of the transaction and an increase in the working capital requirement to take account of the cash push by Mirror Group at year-end. In total these amount to around £[✄] million, comprising £[✄] million of expenses, £[✄] million for increasing the Mirror Group working capital and £[✄] million for breaking existing Mirror Group hedges. Taking account of these items, pro forma net debt increases to £[✄] million whilst gearing [✄].

3.98. Trinity told us that Barclays Bank Plc had provided a letter of comfort to it indicating that sufficient bank facilities would be available to the combined group to refinance existing debt, the cash element and a working capital facility, based on Trinity's model.

3.99. Table 3.12 sets out the pro forma balance sheet for the combined company based on the 1998 year-end figures for each company, adjusted to reflect the terms of the proposed offer and the disposals, but before the costs referred to in paragraph 3.97.

TABLE 3.12 **Pro forma combined balance sheet, taking account of the acquisition of Mirror Group by Trinity under the terms of the proposed offer**

£ million

	Actual 31.12.98			Pro forma
	Trinity	Mirror Group	Adjustments	Combined*
Property, plant and equipment	122	360	0	482
Intangible assets (publishing rights and titles)	349	205	986	1,540
Stocks and debtors less creditors (excluding debt)	(9)	(80)	0	(89)
Net operating assets	462	485	986	1,933
Investments	5	69	(55)	19
Net debt	(66)	(489)	(42)	(597)
Deferred taxation	(12)	(34)	0	(46)
Other	(9)	(3)	0	(12)
Net assets	380	28	889	1,297
Share capital and reserves	380	28	889	1,297
				per cent
Gearing	17	1,753		46

Source: The Commission based on information provided by Trinity.

*Combined pro forma is before the costs referred to in paragraph 3.97.

3.100. Table 3.13 sets out a pro forma profit and loss account based on 1998 figures for each company, adjusted to reflect the proposed terms and the disposals, but before any cost savings or increases in revenue as a result of the merger (see paragraph 3.117).

TABLE 3.13 **Pro forma combined profit and loss account, taking account of the acquisition of Mirror Group by Trinity under the terms of the proposed offer**

£ million

	Actual 31.12. 98			Pro forma
	Trinity	Mirror Group	Adjustments	Combined*
Turnover	342	697		1,039
Trading profit	81	130		211
Associates	0	8	(8)	0
Interest	(8)	(38)	(3)	(49)
Pre-tax profit	73	100	(11)	162
Tax	(23)	(29)	3	(49)
Profit after tax	50	71	(8)	113
Earnings per share (p)	35.9			37.8
Interest cover (times)	9.6	3.4		4.3

Source: The Commission based on information provided by Trinity.

*Combined pro forma is before the cost savings and revenue enhancement referred to in paragraph 3.117.

3.101. Trinity's financial model, which Trinity has stated is on a prudent basis and was primarily for banking purposes, showed that the combined group would be able to make debt repayments year by year, reducing the interest charge, increasing the interest cover and reducing gearing over the following years. Trinity's financial model is based on a number of sources including individual company budgets, their due diligence and brokers' estimates. [

Details omitted. See note on page iv.

]

[*Details omitted. See note on page iv.*]

3.102. Trinity's financial model also included synergies and certain costs identified following the limited due diligence undertaken. [*Details omitted. See note on page iv.*]

RIM's proposed offer for Mirror Group

3.103. No formal offer has been made for Mirror Group. However, the company made a proposal to the Mirror Group board of 200p per share on 14 January 1999, valuing Mirror Group at £913 million. After adding back pro forma net debt at 31 December 1998 of £348 million (see paragraph 3.92), the proposed offer represents a total enterprise value of £1,261 million, representing a multiple of 1.8 times 1998 turnover of £697 million and 9.7 times 1998 trading profit of £130 million. As a comparison, RIM acquired selected newspaper assets from UPN in February 1998 for a consideration of £360 million (excluding costs), representing a multiple of 2.5 times 1997 turnover of £141.2 million and 14.0 times 1997 trading profit of £25.7 million. The share price of Mirror Group at 31 December 1998, prior to any proposed offers being made for the company, was 150p. RIM's proposed offer represented a 33 per cent premium to this price.

3.104. In its analysis of the transaction, RIM assumed that an acquisition of Mirror Group at a value of 200p per share would take place on 30 September 1999 after factoring in the sale of Mirror Group's former stake in SMG and its site in Holborn for a total of £150 million in cash. RIM made a number of further adjustments to construct projected balance sheets for RIM and Mirror Group just prior to the proposed transaction. These included the cost of early redemption of Mirror Group debt and associated hedging instruments (£[✂] million) and the unwinding of the Mirror Group cash push at the end of 1998 (£[✂] million). Acquisition costs are forecast to be £[✂] million.

3.105. Whilst RIM has not yet settled the final structure of the merged entity, following a successful bid, it is envisaged that it will be financed by a combination of senior term debt, high-yield debt and equity finance (including institutional loan stock). The proposed funding structure (gross of financing fees) is set out in Table 3.14. [*Details omitted. See note on page iv.*]

TABLE 3.14 **Proposed capital structure of RIM post-acquisition and comparison with 31 December 1998 position**

	Actual 31.12.98		*Proposed 30.9.99*	
	£m	*%*	*£m*	*%*
Debt				
Senior term loans*	150.0		*Figures omitted. See note on page iv.*	
Senior notes*	66.1			
Senior discount notes (zero coupon)*	53.3			
Finance leases	-			
Cash	(8.9)			
Total debt*	260.5	70		
Equity				
Shareholders' funds	(6.1)			
Institutional loan stock†	115.6			
Total equity	109.5	30		
Total debt plus equity	370.0	100		

Source: RIM.

*Net of financing fees the 1998 balance of senior term loans, senior notes and senior discount notes are £146.7 million, £64.7 million and £52.1 million respectively. Total debt on this basis would be £254.6 million.

†Classified as debt in the RIM 1998 accounts.

3.106. In addition to the existing shareholders of RIM, it is currently intended that MGPE and SPEP will take minority equity stakes in the merged entity. Following the proposed transaction, none of the institutional investors will hold more than 50 per cent of the equity; however, it is likely that Candover and MGPE will hold in excess of 25 per cent of the voting equity in the merged entity.

3.107. On the basis of the analysis provided by RIM the net debt of the combined group immediately after the acquisition would be about £[✄] million. RIM's financial model forecast an increase in net debt of about £[✄] million (in addition to the combined net debt of the two groups prior to the acquisition) and £[✄] million in new equity (including loan stock) to fund the acquisition.

3.108. It is proposed that the senior debt and high-yield bond (including short-term bridge facilities) will be arranged by a leading international bank. RIM is currently negotiating with a number of banks with the intention of selecting the lead bank in May 1999 and negotiating the facilities prior to an offer. The overall quantum of debt will be determined by market conditions and the various components of the debt will be matched to demand at the time of syndication, or, in the case of the high-yield bond, at launch. The debt will, however, be underwritten by the lead arranger at the offer date.

3.109. Table 3.15 sets out the pro forma consolidated balance sheet of RIM taking account of the acquisition of Mirror Group, together with a comparison of the projected pre-acquisition position at 30 September 1999.

TABLE 3.15 **Pro forma balance sheet for RIM, taking account of the acquisition of Mirror Group and comparison with projected pre-acquisition position at 30 September 1999**

£ million

	*RIM pre-acquisition**	*Pro forma for the enlarged group*
Property, plant and equipment		
Intangible assets (publishing rights and titles)		
Goodwill		
Stocks and debtors less creditors (excluding debt)		
Net operating assets		
Net debt	*Figures omitted. See note on page iv.*	
Provision for tax		
Net assets		
Represented by:		
Share capital/share premium		
Institutional loan stock†		
Reserves		
Shareholders' funds		

Source: RIM.

*This represents RIM's projected capital structure as it would be immediately prior to the acquisition.
†Classified as debt in the RIM 1998 accounts.

3.110. RIM provided us with forecasts regarding its expectations for the enlarged group following acquisition of Mirror Group, which for financial modelling purposes was assumed to take place on 30 September 1999. Turnover for the group is forecast to increase from £[✄] million in 2000 to £[✄] million in 2007. Profit before interest and tax (pre exceptional items) is forecast to rise from £[✄] million to £[✄] million over the same period.

3.111. On the basis of RIM's forecasts, the combined group would incur a net loss after tax of £[✄] million in the year ending 31 December 2000. Included in this loss are exceptional costs of £[✄] million relating predominantly to the [*Details omitted. See note on page iv.*] and restructuring costs (£[✄] million). The forecast net interest expense for the year ending 31

December 2000 of £[✂] million includes capitalized interest on loan stock (£[✂] million) and on senior discounted notes (£[✂] million) totalling £[✂] million. The forecast cash flow for the period after paying cash interest is £[✂] million.

3.112. On the basis of the terms of the proposed offer, RIM estimated that its gearing immediately after the transaction would be [✂] per cent (compared with 233 per cent at 31 December 1998). Based on an average interest rate of [✂] per cent, the interest cover for the year following acquisition is projected to be [✂] times ([✂] times if capitalized interest is excluded from the calculation) rising to [✂] times by 2007 ([✂] times if capitalized interest is excluded from the calculation). This compares with interest cover of 0.9 times in 1998 (1.3 times if capitalized interest is excluded from the calculation).

3.113. The key assumptions made by RIM and underlying the forecasts for the enlarged group, other than those discussed above, are as follows:

— Circulation volumes to continue their long-term decline.

— The advertising revenue assumptions are broadly based on the Advertising Association's growth projections for advertising volume growth adjusted on a title by title basis to reflect RIM management's view of the likely performance.

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— [*Details omitted. See note on page iv.*]

— Newsprint and other major costs, excluding editorial, to move in line with either inflation or circulation volumes and as a result of investment in increased pagination.

— Improvement in debtors days from 68 at the end of 1998 to 48 days through the introduction of RIM debtor management policies.

Proposed strategies following the acquisition

3.114. We asked each of the bidders what they saw as the benefits of the merger and what their proposed strategies would be if successful. Their responses are set out below.

Trinity's proposed offer for Mirror Group

3.115. An acquisition of Mirror Group fits in with Trinity's strategy to acquire contiguous regional newspaper assets, acquire new regional franchises and to extend the range of its business activities. Trinity believed that the combined business would provide greater stability to Mirror Group's national titles and would have a better balance of revenue streams than either of the existing companies. These factors, together with the poor share price performance of Mirror Group, led Trinity to believe that a merger would be beneficial to both parties.

3.116. At this point, Trinity has only conducted a limited amount of due diligence of the operations of Mirror Group and has no fixed plans for the enlarged group. Based on this level of due diligence, Trinity's proposed strategies following the acquisition in terms of cost savings and revenue enhancement, management structure and the future plans for the business are considered in the following paragraphs.

Cost savings and revenue enhancement

3.117. Trinity stated that it would expect to generate around £[✂] million a year in cost savings and additional revenues from the combined group. Trinity believed that the sort of benefits likely to accrue from the transaction could include:

— elimination of duplicated functions (for example, eliminating a head office);

— reduction in purchasing costs, especially newsprint;

— [✄]

— sharing new media development costs;

— [✄]

— sharing technology costs;

— optimizing the utilization of printing facilities; and

— revenue development.

Management structure

3.118. [

Details omitted. See note on page iv.

]

Future plans

3.119. Trinity would expect to continue Mirror Group's current level of investment in the national titles and build on the rejuvenation plan implemented by Mirror Group in 1997 and 1998 (see paragraph 3.37).

3.120. Trinity's financial model provided for capital expenditure for the combined group of £[✄] million a year. This compared with actual capital expenditures in 1998 of £21.0 million for Trinity and £24 million for Mirror Group. Trinity indicated that this was a prudent basis against which to judge cash flow available for debt repayment.

RIM's proposed offer for Mirror Group

3.121. The acquisition of Mirror Group appealed to RIM owing to the complementary nature of the Mirror Group regional newspaper business with that of RIM. RIM believed this would provide scope for cost savings and that Mirror Group's regional newspapers would benefit from the focused experience of RIM's senior management.

3.122. RIM's proposed strategies following the acquisition may be considered in terms of cost savings and revenue enhancement, management structure and the future plans for the business. We consider these in the following paragraphs.

Cost savings and revenue enhancement

3.123. RIM identified £[✄] million a year in cost savings and revenue enhancements that would result from the running of the merged business (net of a projected increase in costs of £[✄] million to implement the Fairness at Work legislation and associated Directives). RIM believed these benefits would accrue from:

— reduction in corporate costs associated with being a plc (£[✄] million);

— [*Details omitted. See note on page iv.*]
—

— savings in production costs, primarily saving on newsprint (£[✄] million);

— increase in advertising revenue through the offering of joint packages between titles (£[✄] million); and

— other savings including centralization of finance and administration, reduction in cost of central services, reduction in distribution costs through sharing of delivery, [*Details omitted. See note on page iv.*] and the elimination of duplicated systems development costs (£[✄] million).

Management structure

3.124. RIM's proposal envisaged that the structure of the enlarged company would be similar to that of Mirror Group at present with the existing RIM regional newspaper business being merged with Mirror Group's regional newspaper businesses. The structure envisaged six operating units (national newspapers, regional newspapers, Scotland and Ireland, national advertising sales, magazines and exhibitions and new media) reporting to the Group Managing Director. The headquarters of the enlarged group would be at Canary Wharf in London.

3.125. [*Details omitted. See note on page iv.*] RIM wanted to bring about a significant change in the management culture within Mirror Group. RIM proposed improving the performance of each operating centre with a new simplified organizational structure and the introduction of new financial disciplines.

3.126. [*Details omitted. See note on page iv.*]

3.127. It is envisaged that there would be a two-tier board structure: a holding board comprised of the non-executive Chairman, Chief Executive, Group Managing Director, Finance Director and representatives of the principal investors; and an Executive Board which would include the main board executive directors plus the Managing Directors of each operating unit, the Operations/IT Director and the Legal/HR Director. The Executive Board would be the engine room that drives performance.

Future plans

3.128. The management team believed that by applying the management disciplines and focus it had already applied at RIM, it could improve the trend in circulation of Mirror Group's national and Scottish titles. RIM intended to make substantial investments in Mirror Group's national titles to improve and broaden the content, increase the number of editorial pages as well as improving each newspaper's magazine supplements. It also intended to position the national titles to retain C1 readers and to distinguish the positioning of the *Sunday Mirror* and *Sunday People* titles.

3.129. RIM intended to review a number of Mirror Group's non-newspaper interests, particularly its specialist magazines and exhibitions business, [*Details omitted. See note on page iv.*].

3.130. RIM forecast to spend £[✄] million each year on capital expenditure for the enlarged group (compared with actual capital expenditure in 1998 of £24 million for Mirror Group and £8 million for RIM).