

Part II

Background and evidence

3 The companies and the merger situations

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Introduction

3.1. In this chapter we present the financial performance of the companies involved in the merger situations and the reasons provided to us for the proposed mergers between the parties. The proposals

envisage mergers of (a) UNM with Carlton, and (b) Granada with UNM, or (c) Granada with Carlton, ie consolidation of any of the three main ITV licence holders to two. We then go on to look at the impact that particular mergers would have on the combined entities. Finally we consider other related issues, such as the respective interest of the parties in digital broadcasting (ONDigital) and other terrestrial TV channels, and the synergies and benefits to be expected from each proposed merger.

3.2. Table 3.1 shows an overview of the turnover, operating profits and net operating assets for each of the three parties (including and excluding intangible assets) for the four years from 1996 to 1999. A significant proportion of UNM's net operating assets (including intangibles) consisted of goodwill, compared with Carlton and Granada. Table 3.2 shows the turnover, operating profits, and net operating assets for the three parties' broadcasting and related activities for the three years from 1997 to 1999. The information in Tables 3.1 and 3.2 is taken from the detailed information shown in the sections below for each company. We noted that operating profit as a percentage of turnover for the parties' media activities in 1999 was 28 per cent for Granada, followed by 20 per cent for Carlton and 11 per cent for UNM. For 1998/99, in terms of returns on average net operating assets (including intangibles), Granada's return was 98 per cent, compared with 73 per cent for Carlton and a return of 13 per cent for UNM (reflecting the high level of intangible assets shown in its balance sheet).¹

TABLE 3.1 Overview of performance for the three groups, UNM, Carlton and Granada, 1996 to 1999*

	<i>£ million</i>			
	1996	1997	1998	1999
<i>UNM—years to 31 December</i>				
Turnover	1,990	2,266	2,205	2,171
Operating profit before amortization of goodwill†	283	369	349	316
Operating profit after amortization of goodwill†	167	205	182	72
Net operating assets (excluding intangibles)	537	533	376	193
Net operating assets (including intangibles)	1,621	1,894	1,574	1,949
<i>Carlton—years to 30 September</i>				
Turnover	1,678	1,749	1,842	1,938
Operating profit	291	318	308	320
Net operating assets (excluding intangibles)	507	491	637	669
Net operating assets (including intangibles)	528	538	681	815
<i>Granada—years to 30 September</i>				
Turnover	3,817	4,091	4,031	4,102
Operating profit	670	879	977	999
Net operating assets (excluding intangibles)	4,272	3,734	3,879	4,247
Net operating assets (including intangibles)	4,272	3,734	3,879	4,291

Source: The companies.

*Market capitalization at 10 April 2000: UNM £4.0 billion, Carlton £4.8 billion and Granada £12.4 billion.

†Amortization of goodwill was significant for UNM—see Table 3.3. For example, in 1996, it was £116 million and increased to £244 million in 1999.

¹UNM said that in 1998 it implemented the new Financial Reporting Standard on Goodwill and Intangible Assets, and chose to bring unamortized goodwill on prior acquisitions back into the balance sheet. This had the effect of increasing the net operating assets, whilst reducing reported operating profit as a result of the annual charge for goodwill amortization.

TABLE 3.2 Turnover and operating profits for UNM's, Carlton's and Granada's broadcasting and related activities, 1997 to 1999

	<i>£ million</i>		
	1997	1998	1999
<i>UNM—years to 31 December (see Tables 3.4 and 3.8)</i>			
Turnover	475	562	562
Operating profit*	59	68	60
Net operating assets (including intangibles)†	559	493	411
Net operating assets (excluding intangibles)‡	175	177	166
<i>Carlton—years to 30 September (see Tables 3.10 and 3.14)</i>			
Turnover	826	832	859
Operating profit	149	161	176
Net operating assets (including intangibles)†	211	195	285
<i>Granada—years to 30 September (see Tables 3.16 and 3.20)</i>			
Turnover	677	942	998
Operating profit	188	255	275
Net operating assets (including intangibles)†	228	334	226
<i>per cent</i>			
<i>Operating profit as percentage of turnover</i>			
UNM*	12	12	11
Carlton	18	19	20
Granada	28	27	28
<i>Operating profit as percentage of average net operating assets (including intangibles)†</i>			
UNM*‡	17	13	13
Carlton	71	79	73
Granada	92	91	98

Source: CC and the companies.

*The operating profit is before amortization of goodwill.

†Intangible assets were a large proportion of UNM's balance sheet. They were a smaller proportion in the case of Carlton and Granada.

‡UNM's returns on average net operating assets (excluding intangibles) were 52 per cent for 1997, 39 per cent for 1998 and 35 per cent for 1999.

UNM

History and activities

3.3. UNM is a public company operating in the media, business services and consumer publishing sectors. It is listed on the London Stock Exchange and at 10 April 2000 its market capitalization was £4.0 billion and it had a P/E ratio of 28. UNM told us that it currently had two major shareholders with interests over 3 per cent which were financial institutions with interests totalling 15.1 per cent.

3.4. UNM acquired its current form in 1996 when United Newspapers plc merged with MAI, bringing together, from United Newspapers plc, Express Newspapers PLC (national newspapers), United Provincial Newspapers Limited (regional newspapers), United Advertising Publications PLC (advertising periodicals), and Miller Freeman Worldwide PLC (Miller Freeman) (exhibitions); and from MAI, Meridian TV which bid successfully for the ITV franchise for southern England in 1990; Anglia Television Group PLC (Anglia) acquired by public offer in 1994; Garban Limited and Harlow Butler Broking Services Limited (financial services); and NOP Research Group Limited (NOP) and Mediamark Research Inc (market research).

3.5. Since 1996, UNM has:

(a) acquired Blenheim Group plc (an exhibitions organizer) (1996);

(b) disposed of its regional newspaper interests (1997/98);

- (c) acquired HTV Group plc (HTV), the ITV licensee for Wales and the western region of England (1997);
- (d) demerged its financial services businesses as Garban plc (1998);
- (e) acquired CMP Media Inc (CMP), a leading US technology media company in June 1999, at a cost of £564 million (on which goodwill was £616 million); and
- (f) disposed of Visual Communications Group (a professional images and stock photography business) (2000).

3.6. UNM said that since 1998 it had accordingly become a focused international media and information group, currently operating in three principal areas:

- (a) business services, which includes business exhibitions and magazines and market research information;
- (b) consumer publishing, comprising UK newspapers and advertising periodicals in the UK and USA; and
- (c) broadcasting and entertainment, including TV and related activities.

We comment on these in the following paragraphs.

Business services

3.7. The business services division accounted for 50 per cent of the group's continuing turnover in 1999 (see Table 3.4), achieving revenues of £1,091 million, an increase of 34 per cent over the previous year. Operating profits were £193 million, equating to a return on turnover of 18 per cent (1998 £157 million and a 19 per cent return).

3.8. UNM said that Miller Freeman was the world's largest trade show organizer and a leading business magazine publisher, and is UNM's largest subdivision. It operated around the world and its products consist of a portfolio of more than 370 exhibitions and conferences and nearly 400 publications.

3.9. CMP was purchased in June 1999. UNM said that CMP was a leading US technology media company with a worldwide network of leading brands. These included many of the most important names in computing and electronics print publishing, through which CMP reached some of the most influential readers in the electronics market, the reseller channel, and in end-user markets. CMP also operated 40 leading online sites.

3.10. UNM told us that its United Information Group was one of the world's top five custom research organizations and provided market research and information to a wide range of clients with a particular focus on the media, health care, automotive and business-to-business industries. United Information Group included NOP in the UK, which UNM noted was the second largest ad hoc market research company in the UK and provided largely custom tailored market research.

3.11. UNM also had a US subsidiary, PR Newswire Association, Inc, which was a leading provider of corporate news distribution services to the media and financial community worldwide and the largest distributor of full text corporate information in the USA.

Consumer publishing

3.12. The consumer publishing division, with turnover in 1999 of £518 million (1998 £504 million), accounted for 24 per cent of UNM's continuing group turnover, and had an operating profit of £56 million (1998 £65 million). The return on turnover was around 11 per cent (1998 13 per cent) as shown in Table 3.4.

3.13. UNM's best-known publications in the UK are its Express Newspapers titles, which comprise *The Express*, the *Sunday Express* and the *Daily Star*. The newspaper turnover for 1999, and average daily circulation (based on the six months to 2 January 2000), were as follows:

- (a) *The Express*: turnover £[] million, circulation of 1,059,000;
- (b) *Sunday Express*: turnover £[] million, circulation of 980,000; and
- (c) *Daily Star*: turnover £[] million, circulation of 522,000.

UNM told us that in 1999 £[] million ([] per cent) of its TV advertising revenue turnover was from advertising placed by its related newspaper and media activities.

Broadcasting and entertainment

3.14. UNM's broadcasting and entertainment division (UBE) had turnover in 1999 of £562 million (1998 £562 million) and contributed operating profits of £60 million (1998 £68 million) which equated to a return on turnover of 11 per cent (1998 12 per cent) as shown in Table 3.4. UNM said that its interests in broadcasting and entertainment comprised the following:

- (a) in the broadcasting sector, three ITV regional franchises—Anglia TV, Meridian TV and HTV which we discuss in the following paragraphs—and minority interests in Channel 5, SDN and ITN (see separate sections below);
- (b) in the production sector, United Productions Limited (United Productions), United Wildlife Limited (United Wildlife) and a 50 per cent interest in ITEL,¹ which acted as a programme distributor both for some of UNM's productions and those of third parties (UNM's entertainment division is in the course of acquiring the 50 per cent of ITEL which it does not currently own);
- (c) in the online sector, United Interactive, which comprises Anglia Multimedia and Definition Digital Media, and joint ventures with British Telecommunications plc (BT), namely Anglia Campus and Line One;
- (d) TSMS Group Limited (TSMS), an airtime sales house that sold TV advertising time on behalf of the licensees in the UNM group and certain independent licensees, as discussed in paragraph 3.19; and
- (e) interests in Satellite Information Systems Limited, which provided live satellite coverage of horse racing and satellite broadcast facility services (20 per cent); Village Roadshow; an Australian entertainment production company (18.1 per cent); Football Hall of Fame, a football exhibition based at the old County Hall building in London; Rapture, a youth-orientated cable and satellite channel; and Paradigm, a research and broadcasting consultancy in which UNM had a 50 per cent interest.

We discuss the TV-related activities in the following paragraphs.

Anglia Television Limited

3.15. Anglia went on air in 1959 and today serves a population of more than 4 million in the East of England from its production headquarters in Norwich. Anglia's current licence will expire in December 2002. In 1998 UNM applied for early renewal of the licence from 1 January 1999 for a ten-year period, but rejected the proposed terms offered by the ITC. It said that a further application for renewal will be made shortly. Table 4.1 shows the relative populations and share of TV advertising achieved by UNM's licences in 1999.

¹International Television Enterprises Limited.

HTV

3.16. HTV is the ITV licensee for Wales and the western region of England, operating from principal bases in Cardiff and Bristol. HTV's licence was renewed with effect from 1 January 1999 for a period of ten years.

Meridian TV

3.17. Meridian TV is the ITV broadcaster for south and south-east England, an area that extends to the Thames estuary in the North and to Dorset in the West. Meridian TV was awarded its ITV licence in 1991 and began transmission on 1 January 1993. Its licence was due to expire in December 2002 but has been renewed early for a further ten-year period which commenced on 1 January 1999. Each year Meridian TV produces over 1,300 hours of new regional programmes.

3.18. Currently, UNM has a 79.9 per cent shareholding in Meridian TV, and Carlton holds 20 per cent (the balance being held by employees).

TSMS Group Limited

3.19. TSMS acts as the airtime sales contractor for UNM's three ITV licensees, Anglia TV, Meridian TV and HTV. It has also become the main sales house that sells airtime on behalf of Scottish TV, Grampian TV, Ulster Television plc (Ulster TV), S4C and Channel Television Ltd (Channel TV). UNM said that TSMS had an independent Chairman and management in order to maintain an arm's length relationship with UNM's head office and so protect the interest of its sales house clients which were outside the UNM group.

3.20. The role of TSMS is to liaise with advertisers and advertising agencies, book commercial airtime and provide break schedules, all with the aim of maximizing the broadcaster's revenue.

3.21. It became a subsidiary of UNM in 1994 in the aftermath of MAI's acquisition of Anglia TV, which was, at that time, a 43 per cent shareholder in TSMS. Meridian TV's airtime sales had, until that time, been handled by Merlin Broadcast Sales Limited (Merlin), a sales house in which Meridian and Carlton were both 50 per cent shareholders. Meridian TV transferred its holding in Merlin to Carlton and MAI acquired the balance of the TSMS shares from Central TV as part of the establishment of the three present ITV sales houses which implemented the undertakings given by MAI, Carlton and Granada as a condition of avoiding merger references in 1994. We discuss the roles of sales houses in the TV advertising process in greater detail in Chapter 4.

Profitability and performance

3.22. Each of the three divisions within the UNM group is run by its own management team reporting to the board. Each division has its own management structure including a board with general management and functional heads. Each division also has a Finance Director and a financial function within it. The Financial Director reports to his Managing Director although in addition he has a secondary reporting line to the Group Finance Director. Each Managing Director in turn reports to the board via the Chief Executive. Other functional heads in the divisions also have a secondary reporting line to group functional heads.

3.23. UNM said that the divisions within its group were run autonomously as profit centres. Budgets and strategic plans were discussed and agreed with the main board each year. The respective Finance Directors of each division reported to and met with the Group Finance Director on a regular basis. The financial reporting was carried out in accordance with UK accounting standards and divisional manage-

ment accounts were supplied to the main board on a monthly basis. The management accounts included the individual results for the separate business units, which were set out in the organizational and management charts.

3.24. UNM said that once the merger had been completed with Carlton and all companies were fully integrated, it envisaged that its present division of the business would continue with each division continuing to have separate managerial independence.

3.25. Table 3.3 shows a summary of UNM's consolidated profit and loss accounts for the four years to 1999. Turnover increased from nearly £2.0 billion in 1996 to roughly £2.2 billion in 1997, 1998, and 1999. Operating profits (after amortization of goodwill) were £167 million for 1996, increased to £205 million in 1997, fell to £182 million in 1998 and decreased to £72 million in 1999. The operating profit (before amortization of goodwill) as a percentage of turnover was in the range 14 to 16 per cent over the four years. UNM's financial review to shareholders for 1999 noted that the board's objective was to focus the group on activities where it believed UNM could be a leading player. It added that the financial performance for 1999 reflected the consolidation of the business and UNM's strategy of investment in online opportunities. The loss before taxation for 1999 of £42 million compared with a profit of £72 million (excluding an exceptional profit of £298 million), and reasons for the change noted by UNM were the increase in amortization of intangible assets from £167 million in 1998 to £244 in 1999 (see also paragraph 3.35), and losses on online activities of £21 million for 1999 compared with smaller losses of £8 million for 1998.¹

TABLE 3.3 UNM: consolidated profit and loss accounts, 1996 to 1999

	Years ended 31 December			
	1996	1997	1998	1999
	<i>£ million</i>			
Turnover	1,990	2,266	2,205	2,171
Net operating costs	<u>(1,707)</u>	<u>(1,897)</u>	<u>(1,856)</u>	<u>(1,855)</u>
Operating profit on ordinary activities before amortization of goodwill	283	369	349	316
Amortization of goodwill	<u>(116)</u>	<u>(164)</u>	<u>(167)</u>	<u>(244)</u>
Operating profit on ordinary activities after amortization of goodwill†	167	205	182	72
Share of associated companies' profits	21	2	2	5
Profit/(loss) on disposal of businesses	138	(7)	298*	0
Exceptional items	<u>(127)</u>	<u>18</u>	<u>(71)</u>	<u>(50)</u>
Profit before interest	199	218	411	27
Net interest payable	<u>(13)</u>	<u>(56)</u>	<u>(41)</u>	<u>(69)</u>
Profit/(loss) on ordinary activities before taxation	186	162	370	(42)
Taxation charge	<u>(86)</u>	<u>(83)</u>	<u>(73)</u>	<u>(55)</u>
Profit/(loss) after taxation	100	79	297	(97)
Minority interests	(6)	(10)	(9)	(8)
Dividends	<u>(115)</u>	<u>(119)</u>	<u>(215)</u>	<u>(111)</u>
Retained earnings	(21)	(50)	73	(216)
<i>Performance indicators summary</i>				
Turnover changes per year (%)	‡	14	-3	-2
Operating profit (before amortization of goodwill) as percentage of turnover (%)	14	16	16	15
Profit before interest as percentage of turnover (%)	10	10	19	1
Average employee numbers (full-time equivalents)	18,318	18,150	15,096	15,842
Change in employee numbers (%)	‡	-1	-17	+5

Source: UNM listing particulars and published accounts.

*Profit arises from the sale of regional newspapers.

†In 1998 UNM demerged its Garban financial services business to an independent Garban plc, which for 1998 had sales of £293 million and operating profits of £40 million.

‡Not available.

¹UNM further said that it had restated its accounts in 1998 to bring all unamortized goodwill back on to its balance sheet. This gave rise to a significant charge for goodwill amortization, reducing operating profits. If UNM had adopted the approach taken by many other companies, whereby goodwill was only capitalized as an intangible asset for acquisitions made from 1998 onwards, the intangible assets shown on the balance sheet, and the corresponding charge for amortization, would have been significantly lower.

3.26. Table 3.4 shows UNM's performance for the four years to 1999 analysed by core activities. The broadcasting and entertainment division showed turnover of £376 million in 1996, which increased to £562 million for both 1998 and 1999; and operating profits over this period increased from £47 million to £68 million in 1998 and then decreased to £60 million in 1999. The operating profit as a percentage of turnover for this division has remained constant at around 12 per cent over the period. UNM reported that in 1999, £1,127 million turnover (52 per cent) was from the UK, £869 million was from North America (40 per cent), £135 million from Europe and the Middle East (6 per cent) and the balance of £40 million (2 per cent) was from the Pacific region.

TABLE 3.4 UNM: analysis of performance by main activity, 1996 to 1999

	Years ended 31 December			
	1996	1997	1998	1999
<i>£ million</i>				
<i>Turnover by division</i>				
Business services	555	783	812	1,091
Consumer publishing	494	488	504	518
Broadcasting and entertainment	<u>376</u>	<u>475</u>	<u>562</u>	<u>562</u>
	1,425	1,746	1,878	2,171
Discontinued operations	<u>565</u>	<u>520</u>	<u>327</u>	<u>0</u>
Turnover per accounts (as shown in Table 3.3)	1,990	2,266	2,205	2,171
<i>Profit analysis</i>				
Operating profit relating to:				
Business services	100	155	157	193
Consumer publishing	48	66	65	56
Broadcasting and entertainment	<u>47</u>	<u>59</u>	<u>68</u>	<u>60</u>
	195	280	290	309
Discontinued operations	<u>85</u>	<u>82</u>	<u>45</u>	<u>0</u>
Total operating profit	280	362	335	309
Share of joint ventures profits	7	11	12	7
Share of associates	<u>17</u>	<u>(2)</u>	<u>4</u>	<u>5</u>
	304	371	351	321
Amortization of goodwill	(116)	(164)	(167)	(244)
Exceptional items	<u>(108)</u>	<u>(39)</u>	<u>(51)</u>	<u>(50)</u>
	80	168	133	27
Non-operating exceptional items	119	50	278	0
Net interest expense	<u>(13)</u>	<u>(56)</u>	<u>(41)</u>	<u>(69)</u>
Profit/(loss) on ordinary activities before tax (as shown in Table 3.3)	186	162	370	(42)
<i>per cent</i>				
Operating profit as percentage of turnover for:				
Business services	18	20	19	18
Consumer publishing	10	14	13	11
Broadcasting and entertainment	12	12	12	11

Source: UNM listing particulars and published accounts.

3.27. In 1999 UNM had 15,800 employees, of whom 6,900 were in the UK, 7,800 were in North America and 1,100 were in the rest of the world. UNM told us that in 1999 Anglia had 455 personnel, Meridian TV 445 personnel, HTV 443 personnel, and the advertising sales house (TSMS) 306 personnel.

3.28. Table 3.5 shows UNM's broadcasting and entertainment revenue for the three years to 1999. In 1999, total advertising revenue for its three ITV licences was £[] million, and programme sales totalled £[] million. UNM obtained a rebate of £[] million from Channel 4 in 1997, and £[] million in 1997/98 under arrangements which are discussed further in paragraph 3.109. For 1999, the operating profit of £[] million was analysed as £[] million from broadcasting, £[] million from production and a £[] million loss from other activities.

TABLE 3.5 UNM: summary of broadcasting and entertainment revenues, 1997 to 1999

	£ million		
	Years ended 31 December		
	1997	1998	1999
<i>Advertising revenue and sponsorship via advertising agencies (broadcasting)</i>			
Meridian TV			
Anglia TV			
HTV			
<i>Programme sales (production activities)</i>			
Meridian TV			
Anglia TV			
HTV			
Anglia Television Entertainment			
United Wildlife			
First Interactive Films			
Total for programme sales*			
Interactive revenues			
Advertising sales via ITV franchisees			
Channel Four recovery			
Total revenue			
<i>Operating profit before amortization of goodwill</i>			
Broadcasting			
Production			
Other			
			per cent
Operating profit as a percentage of revenue	(Figures omitted. See note on page iv.)		

Source: UNM.

*Relates to United Productions.

3.29. UNM said that each of its regional TV licensees had production facilities dedicated to regional programming. The programming which UNM produced for sales to the ITV Network or for external sale was produced by a specialized unit called United Productions.

3.30. UNM noted that some of the successful series that it had produced in recent years were *Hornblower*, *Where the Heart Is* and *Touching Evil*. United Productions won the 1998 British Academy Award for single drama with *No Child of Mine*. In 1997 and 1998 UNM produced over 100 Worldwidetv adult education programmes for Channel 5 in association with the Open University. In 1999 it made 16 children's series for ITV and Channel 5 including the successful factual entertainment *Top Ten of Everything* and the major drama series *The Worst Witch*.

3.31. UNM added that United Wildlife was the world's largest commercial producer of natural history programmes. It combined the international skills and experience of Partridge Films and Survival, which together had won over 200 awards. Survival, based in Norwich, produced for ITV the *Survival* programme, which UNM said was the world's longest-running wildlife series and was one of Great Britain's very successful TV exports. Almost 1,000 programmes had been made since the first was broadcast in 1961 and the series was sold to 112 countries worldwide. Partridge Films is based in Bristol and since 1974 has specialized in high-quality wildlife films. As well as hour-long specials and series, it produces many popular wildlife programmes for the international TV market. Major broadcast partners include Discovery, National Geographic, PBS, Disney Channel, Canal+, the BBC and ITV.

3.32. UNM told us that its interactive activities involved the production and distribution of educational and entertainment CD-ROMs, the production of business-to-business CD-ROMs and the development of web products for companies. AngliaCampus was a joint venture with BT, and was the largest online service in the UK for schools and homes, available both through the Internet and digital interactive TV. UNM also noted its 50 per cent interest in the Line One joint venture with BT, an Internet-based information and entertainment service. It said that the site was one of the UK's top ten and has more than 750,000 registered users.

3.33. Table 3.6 further analyses UNM's broadcasting activities for 1998 and 1999. In 1999 UNM paid licence fees of £[] million (1998 £[] million) on total qualifying revenue of £[] million (1998 £[] million), which equated to [] per cent (1998[] per cent) of qualifying revenues.

TABLE 3.6 UNM: broadcasting activities' detailed profit and loss accounts, 1998 to 1999

		£ million		
		Years ended 31 December		
		1998	1999	
Revenue from airtime sales	(
Revenue from sponsorship				
Other revenue				
Total revenue				
Net operating costs:) <i>Figures omitted. See note on page iv.</i>
Programming costs charged by Network Centre				
Regional programme costs				
Regulatory costs—licence fees				
Industry costs				
Transmission costs				
Overheads				
Operating profit				
		per cent		
<i>Performance indicators summary</i>				
Regulatory costs as percentage of total turnover	(%)	
Operating profit as percentage of total turnover				

Source: UNM.

3.34. Table 3.7 analyses UNM's production activities for 1998 and 1999. Its production activities for 1998 and 1999, of £[] million and £[] million respectively, produced an operating profit of £[] million and £[] million for the two respective years. UNM further said that £[] million revenue in 1999 was from production work on behalf of the Network Centre (1998 £[] million), and these activities produced an operating profit of £[] million (1998 £[] million).

TABLE 3.7 UNM: production activities' detailed profit and loss accounts, 1998 to 1999

		£ million										
		ITV Network	Other UK production*	International programming and distribution†	Other‡	Total						
<i>Year ended 31 December 1998</i>												
Turnover	(
Direct costs												
Gross profit												
Overheads and development												
Operating profit												
<i>Figures omitted. See note on page iv.</i>												
<i>Year ended 31 December 1999</i>												
Turnover												
Direct costs												
Gross profit												
Overheads and development												
Operating profit												
per cent												
1998 gross profit to turnover	(
1999 gross profit to turnover												
1998 operating profit to turnover												
1999 operating profit to turnover												

Source: UNM.

*Represents sales (among others) to S4C, Channel 5, BBC and Channel 5.

†Representing for 1999 mainly sales by ITEL into the USA, Germany and Australia.

‡Including First Interactive Films activities.

3.35. Table 3.8 shows UNM's summarized consolidated balance sheets for the four years to 31 December 1999. Tangible fixed assets have fallen from £364 million in 1996 to £291 million in 1999, but this was more than offset by the increase in intangible assets from £1,084 million in 1996 to

£1,756 million in 1999, which represented mainly goodwill arising from acquisitions.¹ Over this period borrowings have fluctuated between a low of £704 million in 1998 to a high of £1,309 million in 1999, reflecting UNM's acquisitions and disposals. The group operating profits (before amortization of goodwill) as a percentage of average net operating assets (excluding intangibles) were significant at between 69 and 111 per cent over the three years to 1999. UNM included intangibles in its definition of reported net operating assets. When the operating profit after amortization of goodwill was recalculated as a percentage of net operating assets (including intangibles), the return was reduced to 12 per cent for 1997, 10 per cent for 1998, and 4 per cent for 1999. The broadcasting and entertainment division's operating profit (before amortization of goodwill) as a percentage of the division's average net operating assets (including intangibles) was 17 per cent for 1997 and fell to 13 per cent in 1999. UNM said that the reduction was due to the significant increase in the division's net operating assets following the acquisition of HTV in 1997 which gave rise to purchased goodwill of £355 million.

TABLE 3.8 UNM: consolidated balance sheets, 1996 to 1999

	<i>£ million</i>			
	<i>As at 31 December</i>			
	1996	1997	1998	1999
Tangible fixed assets	364	376	280	291
Stock and debtors less creditors (excluding cash)	<u>173</u>	<u>157</u>	<u>96</u>	<u>(98)</u>
Net operating assets (excluding intangible)	537	533	376	193
Intangible assets (mostly goodwill)	<u>1,084</u>	<u>1,361</u>	<u>1,198</u>	<u>1,756*</u>
Net operating assets (including intangible)	1,621	1,894	1,574	1,949
Investments	234	151	122	152
Borrowings less cash	(856)	(1,153)	(704)	(1,309)
Dividend payable	(82)	(66)	(61)	(60)
Long-term creditors and provisions	<u>(95)</u>	<u>(42)</u>	<u>(56)</u>	<u>(71)</u>
Shareholders' funds (as reported)†	822	784	875	661
Broadcasting and entertainment net operating assets (excluding intangible)‡	52	175	177	166
Broadcasting and entertainment net operating assets (including intangible)‡	148	559	493	411
				<i>per cent</i>
<i>Performance indicators summary</i>				
Operating profit (before amortization of goodwill) as percentage of reported average net operating assets (excluding intangible)	§	69	77	111
Operating profit (after amortization of goodwill) as percentage of reported average net operating assets (including intangible)	§	12	10	4
Operating profit (after amortization of goodwill) as percentage of reported average shareholders' funds	§	26	22	9
For the broadcasting and entertainment division:				
Operating profit (before amortization of goodwill) as percentage of the division's average net operating assets (excluding intangible)	§	52	39	35
Operating profit (before amortization of goodwill) as percentage of the division's average net operating assets (including intangible)	§	17	13	13

Source: UNM.

*The increase in 1999 relates to the acquisition of CMP (a leading US technology media company) at a cost of £564 million (on which goodwill was £616 million).

†Shareholders' funds for 1996 were after writing off goodwill of £1.7 billion. The shareholders' funds include minority interests of up to £10 million and are not material for separate disclosure in the table.

‡As reported by UNM, and as adjusted for intangibles and Financial Reporting Standard 12 on contingencies and provisions.

§Not available.

¹In 1998 UNM changed its accounting policy for intangible assets and goodwill in line with Financial Reporting Standards. A prior year adjustment was made to bring unamortized goodwill of £1,360 million on to the balance sheet for 1997. Since then, intangible assets increased to £1,756 million at 31 December 1999; this increase represented the net impact of acquisitions made after annual amortization of goodwill.

3.36. UNM said that in common with other groups in the media industry, its assets tended to be of an intangible nature. Media groups relied on the talent and productivity of individuals and the brand value of media channels rather than on tangible assets and so their balance sheets were not a valid measure of underlying value. The high level of intangible assets in UNM's balance sheet reflected the fact that acquired businesses had themselves tended to have high levels of intangible assets. As a result, a return on operating assets, excluding intangible assets and amortization, tended to be quite high when compared with other industries. When intangible assets and goodwill were included, the return on operating assets fell significantly.

Carlton

History and activities

3.37. Carlton is a media company involved in commercial broadcasting, programme making and the supply of products and services to the TV, film and video industries worldwide. It employed 14,238 people worldwide as at 30 September 1999 (full-time equivalents).

3.38. The company was incorporated in 1939. In 1983 the company merged with Carlton Fox Limited and Carlton Studios Limited and became a listed company. Carlton Fox Limited and Carlton Studios Limited were primarily engaged in photographic, exhibition, design, display and TV services and had been developed by Michael Green, the current Chairman, and his brother David Green (now a non-executive director) during the preceding decade. Together they retain an interest of around 2 per cent in Carlton's equity. Carlton's top 25 institutional shareholders accounted for 57 per cent of its issued share capital at October 1999, with the largest holding at 8.5 per cent and the smallest at 0.6 per cent. Its shares are quoted on the London Stock Exchange and NASDAQ, and at 10 April 2000 it had an equity market capitalization of around £4.8 billion and a P/E ratio of 45.

3.39. Carlton became a listed company in early 1983. At the time it had subsidiaries engaged in TV and photographic production facilities, programming, specialist publishing, exhibition contracting and the design and sale of professional TV equipment.

3.40. During the 1980s and 1990s, Carlton expanded into ITV broadcasting; digital TV, programme production and distribution; audio-visual processing products; video/CD and film processing; cinema advertising; and Internet activities—which we discuss below.

ITV broadcasting

3.41. Carlton has become a significant player in the UK broadcasting market. Its principal interests now include its ownership of the ITV licensees for London Weekday (Carlton), the Midlands (Central TV) and south-west England (Westcountry TV), from which it derives revenue from the airtime sold by its sales house, Carlton Sales.

3.42. Carlton's first move into mainstream British TV broadcasting came in 1987 with the acquisition of a 20 per cent stake in Central. In 1991 Carlton applied for the London Weekday ITV licence. Carlton won the licence to broadcast from January 1993 (as Carlton Television). Subsequent acquisitions included:

(a) a 20 per cent stake in GMTV which had been awarded the national licence to broadcast breakfast TV, replacing TV-am (November 1991). This was increased to 25 per cent in December 1999;

(b) an 18 per cent stake in ITN, the national and international news provider (March 1993);

- (c) the remaining 81 per cent of Central TV that it did not already own (February 1994), including Central's 20 per cent interest in Meridian TV, and Central TV's 18 per cent interest in ITN, of which Carlton resold 16 per cent to give it a remaining interest of 20 per cent in ITN; and
- (d) the acquisition of Westcountry TV in December 1996.

3.43. In December 1998 Carlton accepted the terms offered by the ITC for new ten-year ITV licences for Carlton (London Weekday) and Westcountry TV with effect from 1 January 1999. Central TV will continue to operate under its existing licence, which it will then have the opportunity to renew up until 31 March 2001. Carlton said that Central TV intended to renew the licence on that date. Table 4.1 shows the relative populations and share of TV advertising achieved by Carlton's licences in 1999.

3.44. Carlton produces programmes for a number of customers including ITV as its main customer. Other customers include Carlton's own digital and cable channels as well as the BBC and overseas broadcasters. Carlton also owns Action Time and Planet 24 which are run as self-contained businesses producing niche programming.

Profitability and performance

3.45. Carlton operates through four divisions, which we discuss below: Carlton Media Group, Technicolor, Digital Television, and other, principally Quantel:

- (a) Carlton Media Group is primarily involved in ITV broadcasting, programme making and distribution. In the year 1998/99 the division had net sales of £859 million and operating profit of £176 million (see Table 3.10).
- (b) Technicolor manufactures and distributes pre-recorded video, CD and digital versatile discs (DVDs) and processes motion picture film (see paragraphs 3.51 to 3.53).
- (c) Digital Television includes Carlton's 50 per cent interest in ONdigital, Carlton Online and Carlton digital channels. The subsidiaries in this division had net sales of £10 million in the year 1998/99 and operating losses of £38 million. In addition, losses in 1998/99 from Carlton's 50 per cent share in ONdigital were £75 million and further substantial losses were envisaged in 1999/2000 and 2000/01 (see paragraphs 3.93 to 3.103).
- (d) Quantel, other small businesses and central overheads. The 'Other' division had net sales of £161 million in 1998/99, and an operating loss of £6 million after all the group's corporate costs. Carlton has announced its intention to sell Quantel. In effect, Carlton would then concentrate solely on its TV-related activities.

3.46. Table 3.9 shows Carlton's consolidated profit and loss accounts summary for the four years to 30 September 1999. Carlton's turnover grew by 15 per cent from £1.68 billion in 1995/96 to £1.94 billion in 1998/99, over which period its operating profits increased from £291 million to a peak of £318 million in 1996/97 and since has fallen to £270 million for 1998/99. Carlton pays relatively small levels of interest compared with its pre-interest income and, for example, in 1998/99 its interest charge was £18 million.

3.47. Table 3.10 analyses Carlton's profit and loss accounts by division over the three years to 1999. Carlton Media Group turnover increased by 4 per cent from £826 million in 1996/97 to £859 million in 1998/99, and the corresponding operating profit increased by 18 per cent from £149 million in 1996/97 to £176 million in 1998/99. These results equated to returns on turnover of 18 per cent in 1996/97, which increased to 21 per cent for 1998/99.

TABLE 3.9 Carlton: consolidated profit and loss accounts, 1995/96 to 1998/99

£ million

	Years ended 30 September			
	1996	1997	1998	1999
Turnover	1,678	1,749	1,842	1,938
Net operating costs	<u>(1,387)</u>	<u>(1,431)</u>	<u>(1,534)</u>	<u>(1,668)</u>
Operating profit on ordinary activities	291	318	308	270
Share of associated companies profits/(losses)*	10	10	(8)	(75)
Profit/(loss) on disposal of businesses	(1)	(7)	0	(25)
Exceptional items	<u>0</u>	<u>(4)</u>	<u>10</u>	<u>0</u>
Profit before interest	300	317	310	170
Net interest (payable)/receivable	<u>(5)</u>	<u>(1)</u>	<u>2</u>	<u>(18)</u>
Profit on ordinary activities before taxation	295	316	312	152
Taxation charge	<u>(97)</u>	<u>(104)</u>	<u>(100)</u>	<u>(58)</u>
Profit after taxation	198	212	212	94
Dividends	<u>(79)</u>	<u>(91)</u>	<u>(99)</u>	<u>(107)</u>
Retained earnings	119	121	113	(13)
				<i>per cent</i>
<i>Performance indicators summary</i>				
Turnover growth (%)	†	4	5	5
Operating profit as percentage of turnover (%)	17	18	17	14
Profit before interest as percentage of turnover (%)	18	18	17	9
Average employee numbers (full-time equivalents)	9,876	10,455	13,408	14,238
Change in employee numbers (%)	†	+6	+28	+6

Source: Carlton listing particulars and published accounts.

*For 1998 and 1999, this relates to Carlton's share of ONdigital losses.

†Not available.

TABLE 3.10 Carlton: profit and loss accounts summary by division, 1996/97 to 1998/99

£ million

	Years ended 30 September		
	1997	1998	1999
<i>Turnover*†</i>			
Carlton Media Group	826	832	859
Technicolor	693	820	908
Other	231	183	161
Digital TV	<u>0</u>	<u>7</u>	<u>10</u>
	1,750	1,842	1,938
<i>Operating profit</i>			
Carlton Media Group	149	161	176
Technicolor	124	141	149
Other	45	16	(6)
Digital TV	0	(10)	(38)
Exceptional items	<u>0</u>	<u>0</u>	<u>(11)</u>
	318	308	270
			<i>per cent</i>
<i>Operating profit as percentage of turnover</i>			
Carlton Media Group	18	19	21
Technicolor	18	17	16
Other	19	9	-4

Source: Carlton.

*For 1999, £1,015 million turnover was in the UK (52 per cent), £686 million in the USA (35 per cent), and the balance mainly in Continental Europe.

†Carlton could not provide figures for 1995/96 or earlier on the new divisional basis as shown above.

Other activities

3.48. In June 1996 Carlton made an unsuccessful joint bid with Mirror Group plc for Premier League football TV rights in competition with BSkyB and ITV. It said that BSkyB responded by making a successful offer of higher payments and attributed this to the size of BSkyB's customer base and its related subscription revenue.

3.49. In 1989 Carlton bought UEI plc (UEI) for £508 million. The UEI business included the Quantel and Solid State Logic businesses, involved in developing and manufacturing professional video and sound products. Solid State Logic was sold in December 1999. Currently, Quantel designs and manufactures image processing products for the video, TV, post-production and film industries worldwide. Quantel's products include graphics equipment, tapeless visual effects systems and products that enable broadcasters to store, edit and play TV programmes in a fully tapeless environment.

3.50. Carlton also has post-production facilities in London and Los Angeles for commercials, films and TV programmes.

3.51. Carlton's Technicolor Video business (purchased in October 1988 and incorporating the Nimbus CD business bought in 1998) is a leading producer of pre-recorded video cassettes, which it also distributes in the USA and the UK. In addition, it is a leading independent producer of CDs (audio and ROM) and DVDs. It includes a number of wholly-owned subsidiaries based in the USA and other parts of the world.

3.52. Technicolor Film is a market leader in the processing of motion picture film at plants in the USA, the UK and Italy, principally supplying release prints for cinema exhibition. Technicolor Film also distributes release prints to cinemas in the USA and cleans, rejuvenates and stores them.

3.53. In the year 1998/99, Technicolor had sales of £908 million and an operating profit of £149 million. Carlton has announced its intention to sell all off Technicolor.

3.54. In 1996 Carlton acquired from Rank the business that is now called Carlton Screen Advertising through which Carlton sells cinema advertising in the UK.

3.55. Carlton Online was set up in 1998 to develop an Internet presence. The new company coordinates all Carlton's online activity and has established a series of web sites to access both advertising and transactional revenues. Carlton has also made investments in the Internet-based enterprises People Bank (20 per cent) and Ask Jeeves UK (25 per cent).

3.56. Table 3.11 analyses Carlton's media activities for the three years into the main revenue and cost categories. NAR increased from £546 million in 1996/97 to £636 million in 1998/99. Sponsorship income was relatively small at £9 million in 1998/99. Programme sales income rose from £146 million in 1996/97 to £155 million in 1998/99. For 1998/99, the network schedule costs were £230 million and licence costs were £117 million which equated to 26 per cent and 14 per cent of turnover. The operating profit at £176 million for 1998/99 was 20 per cent of turnover.

3.57. Carlton Media Group had 2,600 personnel in 1999, of which 1,500 were in production, 500 in selling and distribution, and 600 in administration. 1,551 of the staff worked for Carlton TV.

3.58. We asked Carlton to analyse its broadcasting and production activities, and this is shown for 1997/98 and 1998/99 in Table 3.12. Carlton incurred costs to the Network Centre of £[] million for 1997/98 and £[] for 1998/99 which equated to [] per cent of total broadcasting income for both years. The regional programming costs totalled £[] million and £[] million respectively for the two years. The regulatory costs were £[] million for 1998/99 which equated to [] per cent of total broadcasting revenue. Carlton said that its licence costs include an annual cash bid amount and a percentage of qualifying revenue charge (based on NAR and sponsorship revenue). For the 1999 calendar year Carlton's licence costs were:

- (a) for the Carlton TV licence, a £16 million cash bid and 20 per cent of qualifying revenue;

(b) for the Central TV licence, only 11 per cent of qualifying revenue; and

(c) for the Westcountry licence, a cash bid of £1 million and 13 per cent of qualifying revenue.

Carlton said that a further amount, currently around £4 million a year, is paid to fund the running costs of the ITC.

TABLE 3.11 **Carlton Media Group: detailed profit and loss account, 1996/97 to 1998/99**

	<i>£ million</i>		
	<i>Years ended 30 September</i>		
	1997	1998	1999
NAR	546	595	636
Sponsorship	8	10	9
Programme sales*	146	148	155
Other†	86	41	24
Books and video	<u>40</u>	<u>39</u>	<u>35</u>
Total	826	833	859
Channel 4 rebate (see paragraph 3.109)	0‡	23	7
Network schedule costs	(207)	(216)	(230)
Licence cost	(117)	(120)	(117)
Other operating costs	<u>(352)</u>	<u>(358)</u>	<u>(343)</u>
Operating profit	150	162	176
			<i>per cent</i>
<i>Performance indicators summary</i>			
Licence costs as percentage of turnover	14	14	14
Operating profit as percentage of turnover	18	19	20

Source: Carlton.

*Includes Carlton Productions, Action Time, Planet 24 and Carlton International Media.

†Includes income from studios and Carlton Screen Advertising, net of group turnover eliminations. Inter-group income for 1998/99 was £22 million.

‡The rebate of £27 million for 1996/97 was included in turnover for the year.

TABLE 3.12 **Carlton: broadcasting activities' detailed profit and loss accounts, 1997/98 to 1998/99**

	<i>£ million</i>	
	<i>Years ended 30 September</i>	
	1998	1999
Revenue from airtime sales		
Revenue from sponsorship		
Total revenue		
Channel 4 rebate		
Net operating costs:		
Programming costs charged by Network Centre		
Regional programme costs		
Regulatory costs—licence fees		
Industry costs		
Transmission costs		
Overheads		
Operating profit		
		<i>per cent</i>
<i>Performance indicators summary</i>		
Regulatory costs as percentage of total revenue	[]
Operating profit as percentage of total revenue	[]

Source: Carlton.

TABLE 3.14 **Carlton: consolidated balance sheets, 1996 to 1999**

£ million

	As at 30 September			
	1996	1997	1998	1999
Tangible fixed assets	252	276	346	359
Stock and debtors less creditors (excluding cash)	255	215	291	310
Net operating assets (excluding intangibles)	507	491	637	669
Intangible assets	21	47	44	146
Net operating assets (including intangibles)	528	538	681	815
Investments	55	73	46	72
Net (borrowings)/cash	94	95	(60)	(253)
Corporation tax and deferred tax	(101)	(104)	(113)	(67)
Dividend payable	(45)	(51)	(56)	(61)
Shareholders' funds (as reported)	531*	551	498	506
Net operating assets—Carlton Media Group†	‡	211	195	285
				<i>per cent</i>
<i>Performance indicators summary</i>				
Operating profit as percentage of average net operating assets (excluding intangibles)	‡	64	55	41
Operating profit as percentage of reported average shareholders' funds	‡	59	59	54
Carlton Media Group operating profit as percentage of average net operating assets (including intangibles)	‡	71	79	73

Source: Carlton.

*As at 30 September 1996, Carlton had written off goodwill of £1.59 billion against reserves.

†As reported by Carlton including intangible assets. Carlton said that intangible assets in Carlton Media Group were £43 million, £47 million and £134 million at 30 September 1997, 1998 and 1999 respectively.

‡Not available.

Granada

History and activities

3.62. Granada is a major UK listed company. As at 10 April 2000 it had a market capitalization of £12.4 billion and was ranked in the top 30 of the FTSE 100. Its P/E ratio was around 21. In the year ended September 1999 Granada had a turnover of £4.1 billion and a profit (before interest, share of ONdigital losses and exceptional items) of £999 million.

3.63. Granada was incorporated in 1934 to acquire the theatre and cinema operations of Bernstein Theatres, a company owned by Sidney Bernstein (later Lord Bernstein) and his brother Cecil. The company was floated on the London Stock Exchange the following year. In 1954 the company was awarded one of the UK's first commercial TV programme contracts, for the North of England weekday broadcast; in 1961 the company branched into TV rental; and, in 1965, opened its first motorway service area. These activities formed the basis of the company's operations until the 1990s. Many of Granada's cinemas were converted to bingo halls in the 1960s and 1970s and this business was sold in 1991. Thereafter the 1990s saw Granada make a series of important strategic acquisitions. In 1993 the company acquired Sutcliffe,¹ a major contract catering business; in 1995 it expanded its motorway service business by buying Pavilion Services; and in 1996 it greatly enlarged its restaurants business and became a substantial operator of hotels by acquiring Forte Plc. Granada also made important additions to its TV business by the acquisitions of LWT in 1994 and of Yorkshire and Tyne Tees TV in 1997. Table 4.1 shows the relative population and TV advertising shares for Granada's four licences.

3.64. Today the principal activities of Granada are in:

— Media; and

¹Full names for these companies were not provided by Granada and are not important for an understanding of this chapter.

— Hospitality.¹

Granada also has a rental business which supplies TVs and VCRs to consumers and businesses.²

3.65. Granada said that its media activities that were comparable with UNM and Carlton were held principally within Granada Media Group (GMG), which is a division of Granada. However, some significant interests are held directly by the parent company. The principal activities of GMG are the broadcasting, production and sale of TV programming and the sale of TV airtime advertising (an aspect of broadcasting). GMG's principal media interests are:

- (a) *Broadcasting:* GMG holds the ITV licences for Granada (which it has held since 1954), LWT (since 1994) and Yorkshire and Tyne Tees TV (since 1997). These licences cover the North-West, London (weekend), Yorkshire and North-East of England regions. The Granada and LWT licences will expire on 31 December 2002, and Granada told us that it had renewed the Yorkshire TV and Tyne Tees licences for ten years from 1 January 1999.
- (b) GMG currently owns a 50 per cent interest in ONdigital, a 50/50 joint venture with Carlton. ONdigital holds the Multiplex B, C and D licences to broadcast subscription channels on DTT.
- (c) *Airtime advertising sales:* GMG owns Granada Media Sales, an advertising sales house which sells advertising airtime for Granada, LWT, Yorkshire TV and Tyne Tees TV; it also sells airtime on behalf of Border and a number of other third party channels. Granada told us that the sales house operational costs amounted to some £15 million a year.
- (d) *Programme production:* In the UK, GMG owns Granada TV Productions, LWT Productions and Yorkshire Tyne Tees Productions. These companies make programmes for the ITV Network Centre and for other broadcasters. Each company sells its own programmes in the UK. The companies are widely recognized for the quality of their programmes and account for many of ITV's most popular and acclaimed programmes, including *Heartbeat*, *Coronation Street*, *Emmerdale* and *Cold Feet*. Granada Media International, a subsidiary of GMG, handles the international sale of all three companies' programmes.
- (e) GMG also has investments in a number of other UK media businesses which we cover in separate sections below, such as SMG, GMTV, ITN, London News Network and ITV2. Granada also has a 50.5 per cent interest in Granada Sky Broadcasting (GSkyB), a broadcaster of channels via satellite and cable—owned with BSkyB. GSKyB's channels included Granada Plus, Granada Men & Motors and Granada Breeze. Granada said that it was working with a number of partners to develop innovative new channels: for example, with Littlewoods it has developed Shop!, a home shopping channel; and with Manchester United and BSKyB it has developed MUTV, a channel devoted to Manchester United matches and news.

3.66. Outside the UK, GMG has important programme production activities in the USA, Australia, Germany and China.

3.67. On 15 May 2000 Granada's board announced that it was in discussion with Compass Group regarding a potential merger to be followed by a demerger within 12 months to create two new groups:

- (a) a hospitality business comprising Compass Group's existing businesses and Granada's hospitality division; and
- (b) a media group based upon Granada's existing media division, which would be the entity for a possible merger with UNM or Carlton.

¹Restaurants, including contract catering and hotels.

²Granada told us that it was proposing to merge the consumer part of this business, Granada Home Technology, with the equivalent business of Radio Rentals, now owned by Rental Holdings. The parties would each have a 50 per cent interest in the merged business. The parties announced the transaction on 17 December 1999 and have applied for clearance of the merger under the Fair Trading Act. The Secretary of State announced on 19 April 2000 that he had decided not to refer the transaction to the CC provided that a number of undertakings were given to remedy certain competition concerns. Granada has indicated that these undertakings are currently being finalized.

Profitability and performance

3.68. Table 3.15 shows Granada's consolidated profit and loss account for the four years 1996 to 1999. Turnover increased by 8 per cent from £3.8 billion in 1995/96 to £4.1 billion in 1998/99, over which period operating profits increased by 49 per cent from £670 million to £999 million. The operating profits as a percentage of turnover increased from 18 per cent in 1995/96 to 24 per cent in 1997/98 and 1998/99.

TABLE 3.15 Granada: consolidated profit and loss account, 1995/96 to 1998/99

	<i>£ million</i>			
	<i>Years ended 30 September*</i>			
	1996	1997	1998	1999
Turnover	3,817	4,091	4,031	4,102
Net operating costs	<u>(3,147)</u>	<u>(3,212)</u>	<u>(3,054)</u>	<u>(3,103)</u>
Operating profit on ordinary activities	670	879	977	999
Share of associated companies profits/(losses)	7	(1)	(4)	(1)
Digital TV costs	0	0	0	(97)
Exceptional items	<u>(76)</u>	<u>11</u>	<u>40</u>	<u>323</u>
Profit before interest	601	889	1,013	1,224
Net interest payable	<u>(196)</u>	<u>(228)</u>	<u>(240)</u>	<u>(168)</u>
Profit on ordinary activities before taxation	405	661	773	1,056
Taxation charge	<u>(108)</u>	<u>(183)</u>	<u>(209)</u>	<u>(181)</u>
Profit after taxation	297	478	564	875
Minority interests	<u>(2)</u>	<u>(6)</u>	<u>(7)</u>	<u>(9)</u>
Profit for the financial period	295	472	557	866
Dividends	<u>(122)</u>	<u>(139)</u>	<u>(161)</u>	<u>(184)</u>
Retained earnings	173	333	396	682
				<i>per cent</i>
<i>Performance indicators summary</i>				
Turnover growth	60†	7	-1	2
Operating profit as percentage of turnover	18	21	24	24
Profit before interest as percentage of turnover	16	22	25	30
				'000
Average employee numbers (full-time equivalents—group)	66.8	70.5	72.3	78.9
Average employee numbers (full-time equivalents—media)	2.5	2.0	2.8	3.0
Change in employee numbers—media (%)	+4	-19	+40	+7

Source: Granada.

*Granada's actual year-ends are in the final week of September.

†Turnover growth in 1996 was due to acquisitions in the restaurants and hotels divisions.

3.69. Table 3.16 shows Granada's segmental analysis for the four years from 1996 to 1999. The media division showed turnover of £600 million for 1995/96 which increased by 66 per cent to £998 for 1998/99, which compared with operating profits for 1995/96 of £156 million and increased by 76 per cent to £275 million for 1998/99. The media division turnover for 1998/99 was 24 per cent of total turnover, and contributed 27.5 per cent of total group operating profit.

3.70. Table 3.17 shows the turnover of GMG's various activities for the three years to the end of September 1999. For 1998/99 the broadcasting group showed turnover of £[] million and produced operating profits of £[] million ([] per cent return), which compared with the production group that had turnover of £[] million and produced an operating profit of £[] million ([] per cent return).

TABLE 3.16 Granada: segmental summary of profit and loss accounts, 1995/96 to 1998/99

£ million

Years ended 30 September

	1996	1997	1998	1999
<i>Turnover by division</i>				
Media	600	677	942	998
Hospitality:				
Restaurants	1,702	1,721	1,592	1,754
Hotels	814	1,092	941	970
Technology	700	601	383	359
Other	<u>1</u>	<u>1</u>	<u>173</u>	<u>21</u>
Group turnover	3,817	4,091	4,031	4,102
<i>Operating profit by division</i>				
Media	156	188	255	275
Hospitality:				
Restaurants	217	266	292	321
Hotels	168	296	314	332
Technology	126	120	92	81
Other	<u>3</u>	<u>9</u>	<u>24</u>	<u>(10)</u>
Group operating profit	670	879	977	999
<i>per cent</i>				
<i>Operating profit as percentage of turnover by division</i>				
Media	26	28	27	28
Hospitality:				
Restaurants	13	15	18	18
Hotels	21	27	33	34
Technology	18	20	24	23
Other	N/A	N/A	14	-48
Group operating profit	18	21	24	24

Source: Granada.

TABLE 3.17 GMG: turnover and operating profit analysis , 1996/97 to 1998/99

£ million

Years ended 30 September

	1997	1998	1999
<i>Turnover by business group</i>			
Broadcasting	<i>Figures omitted. See note on page iv.</i>		
Productions			
Other income from studio sales and Channel 4			
Media turnover			
<i>Operating profit by business</i>			
Broadcasting	<i>Figures omitted. See note on page iv.</i>		
Productions			
Central			
Other (unexplained)			
Media operating profit			
<i>per cent</i>			
<i>Return on turnover for:</i>			
Broadcasting	\approx		
Productions			
All media activities			

Source: Granada.

3.71. We further reviewed Granada's results for its broadcasting and production operations as shown in Tables 3.18 and 3.19. The broadcasting group for 1998/99 had total revenue of £[] million and programming costs of £[] million ([] per cent), licence fees of £[] million ([] per cent), and other costs of £[] million ([] per cent), which resulted in overall operating profit of £[] million ([] per cent).

3.72. The production group had turnover for 1998/99 of £[] million, which is further analysed on Table 3.19. For 1998/99 sales to the Network Centre totalled £[] million and it produced an operating profit of around £[] million ([] per cent of turnover). The other UK production units had turnover of £[] million and the operating profit of £[] million was also [] per cent of turnover. Higher returns on turnover of [] per cent were achieved from international programming and distribution sales.

TABLE 3.18 **GMG: broadcasting activities' detailed profit and loss accounts, 1997/98 to 1998/99**

	<i>£ million</i>	
	<i>Years ended 30 September</i>	
	<i>1998</i>	<i>1999</i>
Revenue from airtime sales	()
Revenue from sponsorship		
Other		
Total revenue		
Net operating costs:		
Programming costs charged by Network Centre		
Regional programme costs		
Regulatory costs—licence fees		
Industry costs		
Transmission costs (analogue)		
Digital costs	<i>Figures omitted.</i>	
Overheads	<i>See note on</i>	
Operating profit	<i>page iv.</i>	
Digital add back*)	
Adjusted operating profit)	
	<i>per cent</i>	
<i>Performance indicators summary</i>		
Regulatory costs as percentage of total turnover	[%]	
Operating profit as percentage of total turnover	[%]	

Source: Granada.

*Digital costs are accounted for by GMG's parent company, and therefore are added back to the broadcasting results.

TABLE 3.19 Granada Productions: detailed profit and loss accounts, 1997/98 to 1998/99

					£ million
	ITV Network	Other UK production*	International programming and distribution†	Other‡	Total
<i>Year ended 30 September 1998</i>					
Turnover	()
Direct costs					
Gross profit					
Overheads and development					
Operating profit/(loss)					
<i>Year ended 30 September 1999</i>					
Turnover	()
Direct costs					
Gross profit					
Overheads and development					
Operating profit/(loss)					
<i>Figures omitted. See note on page iv.</i>					
<i>per cent</i>					
1997/98 gross profit to turnover	()
1998/99 gross profit to turnover					
<i>Figures omitted. See note on page iv.</i>					
1997/98 operating profit to turnover	()
1998/99 operating profit to turnover					

Source: Granada.

*Represents sales to other broadcasters and GSKyB.

†Representing for 1998/99 catalogue sales of £[] million, sales to the USA £[] million, artist services £[] million, channels supply £[] million, and other of £[] million.

‡For 1998/99, studio sales of £[] million, film sales of £[] million, Granada Learning £[]million. Shared costs are mostly allocated to this category, resulting in an operating loss.

3.73. Granada told us that its production activities were a key strength within its media business. It added that whilst significant efficiency gains can be obtained from the broadcasting business by consolidating transmission operations, sales houses, finance and legal systems, such efficiencies were more difficult to extract from the production businesses for a number of reasons. First, Granada strongly believed in maintaining the regional identity of its licences, which provided a unique point of difference between ITV's broadcasting and production businesses and those of competing channels. Secondly, by maintaining creative departments in each licensee, more programme ideas were generated and this had led to Granada's success in winning commissions both from ITV and other broadcasters. Thirdly, Granada was required under the terms of its ITV licences to maintain the same level of production facilities as existed at the time of the licence applications, unless a variation of licence terms was agreed with the ITC. As a result of these factors, Granada said that it maintained a high fixed-cost operation in Manchester, Leeds and London. Staff numbers for each site were respectively 794, 938 and 997 in 1999.

3.74. Table 3.20 shows Granada's consolidated balance sheets, summarized for the four years to the end of September 1999. Group net operating assets ranged between £3.7 billion and £4.3 billion over the period. The group's operating profit as a percentage of average net operating assets was between 22 and 26 per cent over the period. However, for the media division, the operating profit as a percentage of the relevant average net operating assets was in the range 87 to 98 per cent over the four years.

TABLE 3.20 Granada: consolidated balance sheets, 1996 to 1999

	As at 30 September				£ million
	1996	1997	1998	1999	
Tangible fixed assets	4,835	4,299	4,408	4,589	
Stock and debtors less creditors (excluding cash)	(563)	(565)	(529)	(342)	
Net operating assets (excluding intangibles)	4,272	3,734	3,879	4,247	
Intangible assets	0	0	0	44	
Net operating assets (including intangibles)	4,272	3,734	3,879	4,291	
Investments	462	366	97	168	
Borrowings less cash	(3,515)	(2,706)	(2,294)	(2,081)	
Long-term creditors and provisions	(127)	(156)	(117)	(87)	
Shareholder funds (as reported)	1,092*	1,238	1,565	2,291	
Net operating assets for the media division†	179	228	334	226	
					per cent
<i>Performance indicators summary</i>					
Operating profit as percentage of reported average net operating assets	‡	22	26	25	
Operating profit as percentage of reported average shareholders' funds	‡	75	70	52	
Media division operating profit as a percentage of average net operating assets	87	92	91	98	

Source: Granada.

*As at 30 September 1996, Granada wrote off goodwill in shareholders' funds £3.06 billion.

†As reported by Granada, including intangibles. This is broadly comparable with the net operating assets for the group as shown in the table.

‡Not available.

ITV Network Centre

3.75. The Network Centre has an important role in the commissioning of ITV's programmes across the Channel 3 licence regions. We consider the Network Centre in greater detail in Appendix 4.5 and Table 4.20.

Investments by the parties in other TV businesses

Scottish Media Group plc

3.76. Granada has an interest of 18.1 per cent in SMG, with other shareholders being Flextech plc (18.2 per cent), five institutional holders accounting for 22.8 per cent, and 40.9 per cent being held by the public or shareholders with smaller holdings.

3.77. SMG told us that it had a board of twelve directors, of whom four were executives. It noted that Granada had not participated in the policy or decisions of SMG and was not likely to do so in the future. It added that Granada did not have the ability to materially influence the policy of SMG and that there was no coordination of activities between SMG and Granada, either at the strategic or operational level. SMG also confirmed to us its holding of 25 per cent in GMTV and that Granada had no influence over SMG's investment in GMTV.

3.78. SMG holds the two main ITV licences for Scotland (Scottish TV and Grampian TV) and Table 4.1 shows the relative populations and share of TV advertising achieved by these licences in 1999.

3.79. SMG's accounts for the year ended 31 December 1999 showed that it had turnover of £243 million (1998: £207 million) and operating profit of £54 million (1998 £49 million). The segmental analysis for 1999 showed TV turnover of £140 million (1998 £138 million) with operating profit of £36 million (1998 £34 million). SMG had 668 employees in 1999 involved in its TV activities.

3.80. As at 31 December 1999 SMG had total fixed assets of £182 million, stocks and debtors less creditors (excluding borrowings) of £6 million, bank loans and long-term creditors of £111 million, resulting in net assets of £77 million. It analysed its net assets (excluding debt) for its TV activities at £47 million.

Channel 5 Television Group Limited

3.81. Of the three parties, only UNM had an interest in Channel 5. The company was incorporated on 20 January 1995, changing its name to Channel 5 Broadcasting on 31 January 1995 and to Channel 5 Television Group Limited (Channel 5) on 12 March 1996. The company incorporated a wholly-owned subsidiary, which was renamed as Channel 5 Broadcasting on 12 March 1996. It is the Channel 5 Broadcasting subsidiary that was awarded and holds the ITC licence for the Channel 5 TV service (ie the fifth and final national terrestrial channel). The licence was awarded in April 1996 and the channel was launched on 30 March 1997. Channel 5's founding shareholders comprised MAI (now UNM), CLT/UFA (a major French terrestrial broadcasting group), Pearson Television Ltd (Pearson) (part of Pearson plc) and Warburg Pincus Ventures LP.

3.82. By the end of 1999 Channel 5 had reached 19.6 million UK homes (limited by technical broadcasting constraints), which was equivalent to around 80 per cent of all homes with TVs. In November 1999 Warburg Pincus Ventures LP indicated its intention to sell its stake, thereby triggering pre-emption provisions, the exercise of which resulted in UNM's share of voting rights increasing, with effect from 16 February 2000, to 32.7 per cent. As the other shareholders (Pearson and CLT/UFA) recently announced their intention to merge, UNM noted that it would become a minority shareholder, albeit that the Channel 5 shareholders' agreement would give it veto rights over certain matters. It also added that one consequence of its increased interest in Channel 5 was that, under the Broadcasting Act 1996, it was deemed to have attributed to it 50 per cent of Channel 5's audience share (which was 5.3 per cent at December 1999) for the purpose of calculating UNM's audience share to comply with the 15 per cent limit imposed by the Broadcasting Act. We were told that UNM could raise its voting interest to just over 34 per cent, and thereby obtain the right under the shareholders' agreement to veto key aspects of Channel 5's strategy, including the approval of Channel 5's budget, any fundamental change in the means or terms on which airtime was sold, the entry into any contract in excess of £1 million, the appointment of Channel 5's Chief Executive Officer and any other matter as any director of the company might require. UNM confirmed that in late June 2000, it expected to equalize its economic interest and voting interests at 35.37 per cent, but noted that Channel 5 was required by the ITC to have its own independent airtime sales operation and that UNM was not privy to the pricing and other terms on which such airtime was sold.

3.83. Channel 5's audited group accounts for the year ended 31 December 1998 showed turnover of £144 million (1997 £84 million), and an operating loss of £49 million (1997 loss of £168 million). Its loss before taxation was £78 million for 1998 and £182 million for 1997. Its group balance sheet at 31 December 1998 showed tangible assets of £10 million, stocks and debtors less creditors of £84 million, and borrowings of £400 million, resulting in a shareholder deficit of £306 million. It reported average employee numbers of 228 in 1998—of whom 114 were in sales and marketing, 69 in finance and administration, and 45 whom provided programming and technical services. However, in 1997 it reported technical personnel of 2,356 which reduced to 18 in 1998 (as a result of the completion of the video recorder retuning operation). UNM said that Channel 5 was obliged to offer to retune domestic video recorders which were affected by the Channel 5 signal. For 1999, Channel 5 told us that it had 220 employees.

SDN Limited

3.84. UNM is the only one of the merger parties to have an interest in SDN Limited (SDN), which holds one of the six DTT multiplex operator licences (Multiplex A). UNM has a one-third interest and the other shareholders are NTL Limited (NTL) (the cable operator) and S4C (the Welsh language broadcaster for Wales). The SDN multiplex currently carries the following UK services: Channel 5 (digital simulcast of analogue service), BBC Knowledge, Shop!, the channels of the ONrequest pay-per-view film and event service, and TV Travel Shop (part-day). Three further part-day services will be added shortly, as well as a new interactive digital text service from NTL. S4C has the right to use half of the multiplex capacity in Wales, and uses the capacity to offer S4C Digital and S4C2. The remaining S4C

capacity in Wales carries BBC Knowledge and part of the ONrequest service. As a licence requirement, SDN said that it must broadcast Gaelic programmes for at least 30 minutes a day in peak hours in Scotland. The Gaelic service, known as TeleG, started broadcasting in October 1999. SDN estimated that the combined audience share currently generated by the above channels broadcast over Multiplex A was a lot less than 0.1 per cent of total audience share. UNM emphasized that SDN would not receive any direct advertising revenue from any channel operating out of the multiplex, ie it simply earned a carriage fee. However, SDN added that eventually it hoped to obtain a share of transactional revenues from certain services.

Independent Television News Limited

3.85. All the main parties have an equal (20 per cent) interest in ITN, and the remaining shareholders are Reuters, and Daily Mail and General Trust plc (the holding company of *The Daily Mail*). ITN said that it was one of the largest and most respected news organizations in the world, producing news and factual programming for national and international broadcasters. ITN began life in 1955 as a wholly-owned subsidiary of the then ITV licensees. The provisions of the Broadcasting Act as to the ownership of ITN will require the merged company to divest itself of its interest above 20 per cent.

3.86. ITN produces the daily news programmes for all three British commercial terrestrial networks: ITV, Channel 4 and Channel 5. The contract to supply national and international news to the ITV companies runs until 2002. ITN, through its Euronews service, supplies world news 24 hours a day, in six languages, broadcasting via satellite, cable and terrestrial TV.

3.87. ITN's audited accounts for the year ended 31 December 1998 showed turnover of £85 million (1997 £97 million), and an operating profit of £11.5 million (1997 £24.0 million). Its profit before taxation was £11.8 million for 1998 and £21.0 million for 1997. Its consolidated balance sheet at 31 December 1998 showed tangible assets of £26.4 million, investments of £1.2 million, debtors of £12.5 million, cash of £3.1 million, creditors of £26.4 million, and long-term creditors of £16.4 million, resulting in shareholders' funds of £0.4 million. It reported average employee numbers of 756 in 1998 in news services, technical, production and administration activities. For 1999, ITN told us that it had 805 employees.

GMTV Limited

3.88. GMTV holds the National Breakfast ITV licence for broadcasting, and has both Granada and Carlton as shareholders, each owning 25 per cent. The remaining shareholdings are held by Disney and SMG (in which Granada has an interest). GMTV's Chairman's report said that it had renewed its licence for ten years from 1 January 1999 on better terms than previously. GMTV noted that it had argued strongly for a large reduction in its annual licence payments which at over £50 million (fixed cash bid of £39.5 million and a variable levy (at 15 per cent) of £10.8 million for 1998) represented 65 per cent of its revenues in 1998. It noted in its accounts that its annual licence fee would fall by over £30 million to around £20 million each year, with the variable element increasing to 23 per cent of revenues, offset by the fixed cash bid being reduced by over £35 million to around £4 million each year. It concluded that it should therefore trade profitably and move forward through increased investment in programming to strengthen its position as market leader in breakfast TV.

3.89. In 1998, it had 208 employees of whom 150 were in production, 29 were in sales, and 29 were in engineering, administration and transmission. Its total employee costs were £6.9 million.

3.90. GMTV's accounts for the year ended 31 December 1998 showed turnover of £78 million (1997 £78 million), and an operating loss of £13 million (1997 loss of £8 million). Interest payable for 1998 was £753,000. Its balance sheet at 31 December 1998 showed tangible assets of £1.7 million, debtors of £16 million, creditors of £15 million, and an overdraft of £12 million, resulting in net liabilities of £9 million. It had a profit and loss cumulative deficit of £36 million at 31 December 1998, which decreased to £30 million at 31 December 1999.

London News Network Limited

3.91. Carlton and Granada each owns 50 per cent in London News Network. It has four main activities:

- (a) provision of transmission operations for Carlton and LWT, and the ITV Network to the transmitters;
- (b) provision of news programming to LWT and Carlton for the London broadcast area;
- (c) provision of sports programming and event coverage for the ITV Network Centre and other customers; and
- (d) provision of factual programmes for LWT, Carlton and other UK and overseas broadcasters.

3.92. Its total revenues for the year ended September 1999 were £27 million, and operating profit and profit before tax was £900,000. At 30 September 1999 it had fixed assets of £7.6 million, net assets of £4 million and around 285 employees.

ONdigital

3.93. Carlton and Granada are each 50 per cent joint venture partners of British Digital Broadcasting Ltd, which is the parent company of ONdigital. ONdigital in turn holds the licences for digital multiplexes B, C and D and is a DTT broadcaster that commenced activities in late 1998.

3.94. Originally, BSkyB joined Granada and Carlton in the application for DTT licences but the European Commission and the ITC imposed conditions which required BSkyB to cease to have an interest in British Digital Broadcasting Ltd, which left Carlton and Granada each with a 50 per cent interest in the joint venture. BSkyB, however, agreed to supply programming to ONdigital.

3.95. ONdigital was awarded three licences in late 1997 and the ONdigital service was launched in November 1998 as the first commercial DTT service in the world. By March 2000 ONdigital had attracted 672,000 paying subscribers from a standing start.

3.96. In the three years to September 2000, Carlton and Granada have invested or have budgeted to invest £[] million in ONdigital, being £35 million, £172 million and £[] million respectively. These amounts excluded any interest forgone on the investment.

3.97. ONdigital is primarily a distribution platform for channels broadcast over the DTT multiplexes, supplied by BSkyB, Granada, Flextech (through its joint venture with the BBC), Carlton and others. ONdigital told us that it also originated and transmitted some programming and events, notably sports.

3.98. Carlton and Granada noted that digital transmission resulted in more efficient use of the spectrum than analogue transmission and enabled more channels/services to be offered to terrestrial TV viewers. They said that switching off analogue transmission, which the Government hoped to be able to do from 2006 onwards, would release valuable spectrum for other uses and would potentially yield substantial sums to the Government through frequency auctioning.

3.99. To incentivize ITV to promote digital services, Carlton told us that the ITC prescribed that NAR attributable to homes receiving ITV services in digital form would be exempt from the advertising (or percentage of qualifying revenue (PQR)) levy charged on ITV companies' revenue.¹ This rebate off the levy is commonly known as 'the digital dividend'. At present, Carlton estimated that the levy cost ITV companies in aggregate around £240 million a year before digital dividends (ie over £1,000 million

¹Carlton added that The Broadcasting (Percentage of Television Multiplex Revenue) Order 1996 specified that the percentage of multiplex revenue payable by licensees would be zero for licences advertised before 30 September 2000. It noted that the ITC is obliged to give effect to these provisions and to specify how multiplex revenue should be calculated. For ITV, multiplex revenue is calculated on the basis of viewers to the digital service as a proportion of total viewers to the service as a whole. This in effect exempts a proportion of the licensee's revenue from the PQR levy.

over five years) and was likely to increase when the remaining old licences would be renewed in 2001. Granada and Carlton estimated that in the year ended 30 September 2000 the digital dividend was worth to each of them around £3 million (based on estimates of viewers receiving ITV on ONdigital and cable platforms). Carlton and Granada noted that all ITV licence holders could benefit from the digital dividend, and the level of benefit depended on the level of viewing of the ITV digital service in the specific region.

3.100. Carlton added that there was a race between the three platforms (cable, satellite and DTT) to introduce digital decoders into UK households. ONdigital had 552,000 subscribers (as at the end of December 1999) and was competing with BSkyB as a satellite platform with 4.4 million direct-to-home (DTH) satellite subscribers, Cable & Wireless Communications plc as a cable provider with 1.8 million subscribers and Telewest with over 1 million subscribers. Carlton suggested that ONdigital was disadvantaged in that race because it did not have any existing customers to convert to digital—all customers were new.

3.101. Carlton also said that ONdigital was competing with groups that had greater financial resources. Therefore a merger with another media player would provide increased resources to support and develop digital terrestrial broadcasting. It added that ONDigital's major competitor on the satellite platform, BSkyB, had access not only to its own resources but also could benefit from arrangements with British Interactive Broadcasting's shareholders (BT, HSBC and Matsushita), which had established an interactive service on the Sky platform called Open. Similarly it suggested that cable operators could have access to additional resources through their shareholders such as France Telecom, Microsoft and AT&T.

3.102. Table 3.21 sets out information provided by Carlton and Granada on management targets for ONdigital subscriber numbers (together with their view of resultant investment requirements) for the next five years. Carlton noted that although it expected that these targets were achievable in today's competitive environment, it recognized that they could be ambitious. In particular, new initiatives by ONdigital's competitors (for example, roll-out of digital technology by the cable operators and new technology such as ADSL) could have the potential to reduce significantly ONdigital's subscriber growth and profitability. Carlton suggested that tougher competitive conditions could result in lower subscriber growth, thereby lengthening the time to break even and increasing the investment requirement.

TABLE 3.21 ONdigital: cash flow and subscriber number forecasts, 1999 to 2004

	<i>£ million</i>					
	<i>Years ending 30 September</i>					
	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>
Cash flow	(<i>Figures omitted. See note on page iv.</i>)
						<i>million</i>
Closing paying subscribers	[<i>Figures omitted. See note on page iv.</i>]
Average subscribers in year						

Source: Carlton and Granada based on information from ONdigital.

3.103. [

Details omitted. See note on page iv.

]

ITV2

3.104. ITV2 is a new channel launched by the ITV licence holders in December 1998 when ITV had the extra terrestrial capacity of DTT. It was available to viewers of the ONdigital and cable platforms as a free-to-air channel, but was not available on the BSkyB platform. ITV2 is 38 per cent owned by Carlton, 35 per cent by Granada and 26 per cent by UNM, with the remainder of 1 per cent held by other

ITV companies. Its budgeted expenditure for the year 2000 on programming is £[30] million. Its profit and loss account for the 1999 year showed turnover of £[30] million, and an operating loss of £[30] million. Its balance sheet at 31 December 1999 showed net operating assets totalling £[30] and a shareholders' funds' deficit of £[30] million.

Other relevant media groups

Channel Four Television Corporation

3.105. Channel Four Television Corporation (Channel 4) said that it was unique in so far as, although a public service broadcaster, it was entirely financed from commercial revenues. Channel 4 as a service was originally constituted under the terms of the Broadcasting Act 1981. Activities concerning the provision of programmes were provided by Channel Four Television Company Limited, which was a wholly-owned subsidiary of the Independent Broadcasting Authority (IBA) (with £100 issued capital). From 1981 until the end of 1992, Channel 4 was financed by a subscription from the ITV companies, which were allowed to maintain their right to sell Channel 4's TV advertising airtime. A formula was established under which Channel 4 and S4C (the Welsh language broadcaster for Wales) received a subscription of between 14 and 18 per cent of the prior year advertising revenues of ITV, Channel 4 and S4C, as a whole. In 1992 the subscription Channel 4 received from ITV companies was £251 million, and the ITV companies reported that Channel Four's share of the total advertising revenue that year was 13.9 per cent of the relevant total. This, according to Channel 4, resulted in its airtime being sold at a discount of about 35 per cent to ITV's price. Since 1992, Channel 4 has significantly reduced the discount to a small gap, as noted in paragraph 4.117.

3.106. The Broadcasting Act 1990 reconstituted Channel 4's status and established Channel Four Television Corporation, to which was transferred the shares in Channel Four Television Company Limited on 1 January 1993. From that date, Channel 4 became an entirely self-financing statutory corporation, and relied on revenues from sales of its airtime and originating programmes. Channel 4 told us that it had enjoyed considerable success in this area. For example, its share of the ITV, GMTV, S4C and Channel 4 advertising market in 1994 was 18.2 per cent, and in 1999 (after taking account of Channel 5) the share was 21.7 per cent.

3.107. Channel 4 said that its independence from the ITV companies had many advantages in enabling it to carry out its licence obligations to the ITC, which required it to provide a specific number of hours of various categories of programming, and a general requirement to provide innovative, experimental and educational programming. Channel 4 added that, because it did not have to respond to shareholder demands, it was able to provide a wider range of programming than ITV. It noted that it did not seek to alter the programme mix to maximize audiences and minimize the cost of every slot and, as an example, said that it transmitted programmes like Channel 4 News in peak time although theoretically it would be possible to increase the audience and lower the cost at that time.

3.108. Channel 4 noted that, whilst it was not maximizing audience share, its share of total TV audience since 1993 had been pretty stable at between 10 and 11 per cent of the total audience. It said that it sought, within its broad range of programming policy, to maximize advertising revenue and control its costs with commercial efficiency.

3.109. Under the terms of the Broadcasting Act 1990, Channel 4 was required to pay to the ITC, for distribution to the ITV licence holders, half of Channel 4's calendar year revenue in excess of 14 per cent of total qualifying revenue. The qualifying revenue to which this formula related was the total TV revenue of ITV, Channel 4, Channel 5 and S4C. The 50 per cent payment was reduced to one-third for 1998 by the Broadcasting Act 1996. An order was made by the Secretary of State in November 1998 which reduced the percentage payable to ITV to zero for 1999 and subsequent years. The funds released were intended to enable Channel 4 to develop digital programme services and finance the additional film and programme investments required under the new licence conditions.

3.110. Channel 4 lays its accounts before Parliament for approval each year. Its most recent filed accounts were to 31 December 1999, and showed turnover of £642 million (1998 £590 million), and operating profit of £45 million (1998 £88 million). Its profits before taxation were £46 million for 1999

and £26 million for 1998, after payment of a rebate back to the ITV companies of £66 million for 1998. Its direct programme costs for 1999 were £391 million and £352 million for 1998.

3.111. Channel 4's consolidated balance sheet at 31 December 1999 showed tangible fixed assets of £89 million, net current assets of £226 million, and long-term liabilities of £8 million, resulting in shareholders' funds of £307 million.

The merger situations

UNM/Carlton proposed merger

3.112. UNM and Carlton announced their intention to merge on 26 November 1999. The merger was to be effected through an offer made on behalf of UNM for all of the share capital of Carlton in consideration of the issue of new ordinary shares in UNM which would result, when completed, in Carlton's shareholders owning approximately 52 per cent of the combined group (the offer).

3.113. The document setting out details of the offer was dispatched to Carlton's shareholders on 10 December 1999. On the basis of the closing price of 713p per UNM ordinary share on 7 December 1999, the offer valued Carlton at £3.452 billion. The offer was subject, inter alia, to the approval of UNM's shareholders, which was granted at an extraordinary general meeting of the company held on 13 January 2000.

UNM's rationale

3.114. UNM told us that its efforts were driven by the requirement to focus management time and financial resources on those markets where the company had a competitive advantage, and where growth prospects were highest. The management believed that this approach would produce the best returns for shareholders in the medium term. Broadly, the chosen markets were business-to-consumer media activities, principally TV, newspapers and consumer magazines, and selected business-to-business media markets where the company had in-depth knowledge and expertise.

3.115. In early 1998 UNM undertook a fundamental review of the TV market and its role within it. The review took place against the backdrop of a series of fundamental changes within the TV sector that had taken place over the previous four years, for example the launch of multichannel TV by BSkyB in the late 1980s which, UNM said, had shifted the balance of power within the industry away from advertising-funded commercial TV.

3.116. UNM concluded that:

- (a) (
- (b) *Details omitted. See note on page iv.*
- (c))

3.117. This led to a series of strategic objectives, notably to:

- (a) (
- (b) *Details omitted. See note on page iv.*
- (c))

(d)

(e)

3.118. UNM had therefore identified various potential partners to achieve these objectives and having rejected outright acquisition of any of these partners as a viable route, discussions were held with a number of them. As late as August 1999, when a presentation on strategic options was made to UNM's board, the possibility of a merger with Carlton, whilst identified as an option, was not at first seen as a practical possibility. However, UNM said that faster than expected audience loss for ITV had led it to believe that the audience share test might be met, and other regulatory difficulties would prove to be surmountable. UNM also noted that Carlton's strategic vision was similar to its own, which overcame anticipated resistance.

3.119. As discussions with Carlton progressed, it was apparent to UNM that a merger would address for both parties most of the structural problems which UNM's broadcasting and entertainment division had identified in its five-year plan, notably [*Details omitted. See note on page iv.*].

3.120. UNM told us that it was not in a position to discuss the merits of a merger with Granada as it had not had any exchanges with Granada on the subject.

3.121. UNM said that the Internet businesses on which it was also concentrating effort were designed to take advantage of the new types of media business opportunities created by the interactive worldwide web. The Internet allowed the delivery of tailored services and e-commerce, as well as offering a new mechanism for delivering traditional media information and entertainment. It had committed £370 million over two years from March 2000 on these online new media opportunities.

Carlton's rationale

3.122. Carlton told us that its merger proposals with UNM involved a merger of equals in that, following the merger, Carlton shareholders would have held approximately 52 per cent and UNM's shareholders 48 per cent of the issued capital of the new entity. It emphasized that such a merger would make the combined entity into the UK's largest commercial broadcaster with a combined market capitalization of some £9 billion, based on market capitalizations at April 2000.

3.123. Carlton said that the timetable over which the merger with UNM was negotiated began in the second half of September 1999. A meeting was held at UNM's offices at the end of September 1999 attended by the senior management of the two groups. At the meeting Carlton's Chairman suggested that a full merger of Carlton and UNM would be the best way of resolving a potential deadlock over which of the two parties should buy the other's ITV businesses. A series of meetings between the senior managements then took place between October and November and the conclusion reached was that a merger and disposal of non-core businesses would create a strong group focusing on UK media and new media and on business-to-business services, principally in the USA. The proposed merger was announced on 26 November 1999 but, with the referral to the CC, the merger lapsed.

3.124. Like UNM, Carlton also said that it could not comment upon the merits of a merger with Granada. It noted that its arguments in favour of consolidation of ITV companies could apply equally to a merger between it and Granada or UNM, subject to any disposals that Granada might need to make under broadcasting legislation.

Granada with either UNM or Carlton

Granada's rationale

3.125. Granada emphasized its view that, within a timescale of five years, new legislation would enable Regulators to permit the consolidation of ITV regional licensees into the control of a single owner. It therefore felt that the present time was a crucial stage in the process of consolidation from three main players to one, and it wished to play a key role in any interim process of consolidation, as long as

ITV's economic and regional balance was maintained in the period before a single ITV company emerged.

3.126. It said that its media interests reflected its strategy of seeking to build a strong presence in each of the key segments of what it saw as a rapidly converging multimedia market place. Granada's aim of developing a strong position in each media segment was to enable it to exploit new opportunities wherever that arose. This, it said, reduced Granada's risk of being outflanked by technological or market developments. It would also allow Granada to extract maximum value from products which were expensive to create, by spreading its fixed costs across a number of media.

3.127. Granada noted that, although it was already a key player in UK commercial terrestrial broadcasting, scale was becoming increasingly important in the TV sector, particularly with the increasing competition for major programming rights. Granada's strategy was therefore focused on strengthening ITV and to strengthen Granada's position within ITV.

3.128. Granada told us that, without a strategy for ITV's growth and renewal, the increasing take-up of multichannel digital TV would lead to a fall in ITV's audience share. Strengthening ITV and its identity was therefore essential. Granada had worked with other ITV licensees to strengthen the role of the Network Centre and to employ a new senior network management team to help deliver improved programming, audience share and revenue for the ITV Network. Also, a number of steps had been taken to strengthen the ITV brand, for example through the new ITV2 channel and on-screen branding initiatives.

3.129. Granada's aim was to become a stronger player, within a stronger ITV. In a little over five years from 1994, Granada said that it had developed from being a single regional ITV licensee to a media group incorporating Granada, LWT, Yorkshire and Tyne Tees TV, together with interests in ITN, GMTV and SMG.

3.130. Granada said that it aimed to continue to attract, retain and develop the best on- and off-screen talent so that it could continue to be one of the leading programme makers. Granada also sought to use its strengths as a programme producer to take advantage of increased demand for original programming by becoming the producer of choice for both terrestrial and multichannel commissioners.

3.131. Granada pointed out that its strategy of building a presence in each of the key segments meant it had to have a firm foothold in pay-TV; and within pay-TV, acting not only as a content producer, but also as a platform operator and channel developer. Hence it entered into a co-ownership relationship with Carlton for ONdigital; and its development of channels (such as Granada Plus and Shop!) for carriage on ONdigital and other multichannel platforms.

3.132. Granada said that it was committed to developing a broadband and Internet presence, using the strengths it had developed in TV. Granada had also identified a wide range of other opportunities where it could exploit its expertise as a broadcaster and programme producer.

3.133. Granada noted that, with the globalization of the media sector, international scale was increasingly important for Granada to enable it to compete more effectively against the world's major media companies for talent, programming rights and commissions. TV production, in particular, was becoming an international business, as commissions for high-quality programming fully funded by a single domestic channel were becoming increasingly rare. Granada had already established successful programme production businesses in the USA and elsewhere. It added that, although UK ITV companies could fund high-quality programmes from their cash flow, international scale would allow them to reduce the risks of investment.

Benefits and synergies from the proposed mergers

UNM and Carlton merger

3.134. UNM and Carlton considered that the proposed merger of all of their combined business interests, covering, inter alia, TV broadcasting, TV programme production, business services and new media, would yield a number of benefits and be an appropriate competitive response to ITV coming under pressure from alternative media for viewers/audience. In financial terms both UNM and Carlton

separately estimated that the merger could see an improvement in their joint costs of around £40 million a year which are summarized in Table 3.22. The parties additionally noted that there might be one-off costs of delivery¹ of some £24 million in achieving the long-term savings, which would mitigate the immediate savings to around 2001. They emphasized that the focus for the merger was not savings in operational costs but other intangible benefits of a strategic nature, as noted in the following paragraphs.

TABLE 3.22 Potential annual savings from the Carlton/UNM merger

	<i>Estimates by Carlton £m</i>	<i>Estimates by UNM £m</i>	<i>Timescale</i>
Divisional management	<i>Figures omitted. See note on page iv.</i>	†	From 2000
Broadcasting			2000–2002
Production			2000–2001
Airtime sales (back office)			2000–2001
Airtime sales (front office)*			
Distribution/programme sales			From 2000
Interactive and pay-TV activities			From 2000
Property			From 2001
Facilities			From 2001
Corporate head office			2000–2001
Network Centre			From 2001
Purchasing			Not specified
Transmission outsourcing			Not specified

Source: Carlton/UNM.

*Not quantified by Carlton or UNM. Carlton noted that its own sales house had annual costs of some £27 million a year.

†Not identified.

3.135. Carlton and UNM summarized the intangible benefits of a merger between them under the following headings:

- (a) increased competitiveness for ITV against other TV channels;
- (b) improved prospects for ONdigital;
- (c) an improved profile overseas; and
- (d) opportunities in new media.

We comment further on these points in the following paragraphs.

Increased competitiveness for ITV against other TV channels

3.136. The parties emphasized that the greater scale from their merger would enhance the competitiveness of the ITV Channel 3 network against both multichannel pay-TV and its main national terrestrial competitors (BBC1, BBC2, Channel 4 and Channel 5). The proposed merger would not, however, arrest the decline of the ITV Channel 3 network in the face of intense competition from other broadcasters (particularly pay-TV broadcasters), but they claimed it would enable the decline to be managed. They further noted that in many European markets the leading broadcaster's share of NAR substantially exceeded the 35.4 per cent which they believed would arise following their merger.

3.137. They added that their merger would reduce the competitive disadvantage which they believed ITV had suffered from, as a result of ITV Network decisions having to depend upon a consensus of three major ITV licence groupings. They gave as examples decisions on major strategic issues for ITV, such as the development of ITV2 (as a digital channel) and the acquisition of major programme rights. Failures to reach speedy agreement on such matters had adversely affected channel development, platform policy

¹Such as redundancy, relocation and other administration costs incurred in bringing the two groups together.

and the launch of itv.co.uk (the Internet web site for ITV). The existence of two rather than three major players within ITV would therefore, in their view, make it easier and quicker to reach a consensus and thereby counteract any competitive disadvantages of a fragmented network.

3.138. Carlton and UNM believed that a merger of their programming businesses and the parties' broadcasting businesses would reduce costs and enhance substantially the ability of the merged business to supply high-quality programming to the ITV Network and thereby continue to attract high levels of audiences and advertising revenue in a virtuous circle. UNM added that a further benefit would arise from the merger in relation to programme production. It considered that a larger aggregation of licences would give the merged entity a sufficiently strong economic base to try out new programming and amortize the costs across those licences. This would facilitate greater risk taking and increase the likelihood of successful programmes being made which would benefit not only ITV but also the UK economy as a result of increased exports of programming (see also paragraph 3.141).

3.139. UNM also considered that the benefits for ITV noted above would also give rise to benefits to advertisers, since the increased expenditure on programming would increase viewer numbers which would in turn increase the supply of advertising.

Improved prospects for ONdigital

3.140. Carlton and UNM believed that the merged entity would have the resources needed to support and develop digital terrestrial broadcasting. ONdigital in its present nascent phase was a distribution platform rather than a broadcaster. The merger would make it easier for ITV and ONdigital to develop coordinated investments in programming including the acquisition of rights, for example for major sports events, such as the Champions League. They stressed that their merger would result in UNM also having an interest in ONdigital, which would therefore align the interests of all the three present major ITV groups in the DTT platform of ONdigital. At present while Carlton and Granada did provide certain channels on ONdigital, many of its key programmes were supplied by BSkyB (Sky 1, Sky Sports, Sky Movies), which charged accordingly. Hence, their merger would create greater opportunities and incentives for cross-promotion between the ITV Network and ONdigital to develop programmes and channels with appeal against the BSkyB platform, which they noted currently benefited from a far larger subscriber base and had very strong financial resources.

An improved profile overseas

3.141. Carlton and UNM noted that a significant amount of UK programming was being sold overseas and a merged entity would be able to realize efficiencies in programming production and sales so as to be a strong UK-based producer of programmes with international appeal. In addition, the merged entity would find it easier to enter into co-production arrangements and similar ventures with non-UK broadcasters which had, to date, regarded the ITV companies as lacking adequate presence. Such cooperation would further enhance the quality of programming available to the ITV Network. The joining together of Carlton America and UNM's ITEL Los Angeles office would also significantly increase the merged group's visibility in the USA, the main focus of co-production activities. It would therefore offer a stronger presence to key co-producers such as Discovery, Anglia Television Entertainment (a joint venture between UNM and Home Box Office), National Geographic and PBS Public Broadcasting Service (a US channel). This should bring extra funding into British programming and facilitate the development of high-quality co-productions such as the series *Hornblower*. As a joint operation there would also be an opportunity to heighten the merged company's presence in Australia, Japan and Europe.

Opportunities in new media

3.142. The merged group intended to develop web sites providing new commercial opportunities for ITV, and the regions to which the parties broadcast, to compete with the BBC's Internet services, which currently account for 8 per cent of page impressions and are the third most visited sites in the UK. In pursuance of that aim, UNM said that it had launched web sites for Anglia TV, HTV and Meridian TV in March 2000, which provided regional news, weather, programmes, information and details of local services and entertainment along with local classified advertising sections. Carlton and UNM noted in

viewers and drive overseas sales of its UK productions. It added that the strengthening of ITV would be helpful to ONdigital by allowing ITV and ONdigital to bid more effectively for key sports and TV rights in competition with BSkyB. Granada noted that, when it had acquired Yorkshire TV, it had increased Yorkshire TV's regional programmes by 56 hours (8 per cent) and had managed, through a lot of competitive commissioning, to increase Yorkshire TV's network hours by 25 per cent. Granada said that when it acquired LWT, it had managed to increase LWT's network programming by 32 per cent. It therefore felt that it could improve the production capability of any company with which it merged.

3.147. Granada also considered that it had resources to invest in new ITV specialist channels, which could be sold internationally. It noted that investments in new media activities could also amount to many tens to hundreds of millions of pounds. It noted that, since 1994, it had increased its library of programmes to about 60,000 hours and it produced 6,000 hours a year of programming to all channels at present. Granada also added that, on the international stage when competing with other English-speaking programme makers, size, power and distribution were quite important factors.

3.148. Granada told us that ONdigital was not a significant factor in determining whether it would bid for Carlton or UNM.