Part II

Background and evidence

3 The companies and the proposed merger

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Introduction

3.1. RE is jointly owned by Reed and Elsevier. On 27 October 2000 one of RE's subsidiaries, Reed Elsevier Inc (REI), and its wholly-owned subsidiary REH Mergersub Inc (Mergersub) entered into an agreement to offer to buy for cash all the issued and outstanding shares of Harcourt. On the same day REI also entered into an agreement to sell some of Harcourt's businesses to Thomson as soon as its acquisition of Harcourt was completed.

3.2. Harcourt divides its activities into four 'groups'. Following these transactions, RE will retain two of Harcourt's groups, the Worldwide Scientific, Technical and Medical Group (STM Group) and the Education Group. It will also retain the psychological and educational testing businesses of Harcourt's

Corporate & Professional Services Group. The other businesses in this group and Harcourt's Higher Education Group will be sold on to Thomson.

3.3. In this chapter we describe the companies concerned and the proposed merger transactions. All dollar amounts refer to US dollars. RE's accounting year is the calendar year, and Harcourt's is the year to 31 October.

RE

3.4. RE came into existence on 1 January 1993 when Reed and Elsevier transferred their businesses to two jointly-owned companies, Reed Elsevier plc, a UK-registered company which owns all the publishing and information businesses, and Elsevier Reed Finance BV, a Dutch-registered company which owns the financing activities. Reed and Elsevier have retained their separate legal and national identities and are publicly-held companies with separate stock exchange listings in Amsterdam, London and New York.

3.5. Reed traces its roots to a Kent-based paper manufacturing business, Albert Reed & Co, founded in 1894, which became a public company in 1903. It diversified into publishing in 1970 when the company acquired the International Publishing Corporation (IPC), a company comprising newspapers and many magazines, periodical and book publishing businesses. The national newspapers were sold in 1984. In 1986 the board of Reed decided to concentrate on publishing and information businesses, and in the period up to the merger with Elsevier disposed of its manufacturing businesses and made several significant acquisitions of publishing and information businesses.

3.6. Elsevier began as a publishing company founded in Rotterdam in 1880. From the late 1980s Elsevier's strategy was directed primarily towards expansion in publishing and information in English-language information markets. This strategy resulted in the disposal of Elsevier's commercial printing and consumer book publishing operations and in the acquisition of publishing houses active in the fields of scientific, professional and business to business publishing, including the UK acquisition of Pergamon in 1991.

Acquisitions and disposals since formation

3.7. Since its formation in 1993, Reed Elsevier has moved its business towards academic, educational and professional publishing. In 1995 it initiated a major divestment programme to withdraw from consumer publishing. In that year it sold its newspaper businesses in the UK and the Netherlands and its consumer magazines titles in the USA and the Netherlands for £751 million. RE completed the divestment of its consumer book business operations in a series of transactions over 1997 and 1998, and with the sale of IPC magazines in January 1998 for £878 million.

3.8. The proceeds of these disposals were more than £1.7 billion, and they contributed towards the financing of a series of acquisitions in the Science & Medical, Legal and Business segments. The larger acquisitions included:

(a) Lexis-Nexis (formerly Mead Data Central) for £971 million in December 1994;

(b) 50 per cent of Shepard's (a US legal publisher) in 1996;

(c) MDL Information Systems Inc, acquired by Elsevier Science for £195 million in 1997;

(d) Matthew Bender, a US publisher of legal analysis, and the remaining 50 per cent of Shepard's for £994 million in 1998; and

(e) Miller Freeman Europe, a leading trade exhibition organizer, for £360 million in July 2000.

3.9. The total cost of acquisitions since 1993 was £4,811 million, as shown in Table 3.1.

TABLE 3.1 **RE: acquisitions, 1993 to 2000**

£ million

Year	*Cost*	*Net operating assets/ (liabilities)*	*Investments in associates**	*Intangible assets*	*Goodwill on acquisition*
1993	386	(37)	-	321	102
1994	1,071	82	-	475	514
1995	42	2	-	19	21
1996	332	4	69	59	200
1997	725	20	-	254	451
1998	1,219	(10)	(132)	425	936
1999	132	(6)	-	77	61
2000	904	(94)	-	318	680
	4,811	(39)	(63)	1,948	2,965

Source: RE.

*To reflect the piecemeal acquisition of Shepard's.

3.10. The table shows that, after taking account of fair value adjustments, the purchase consideration was essentially wholly attributed to acquired intangible assets and purchased goodwill, as the acquired businesses had net operating liabilities overall. As a result, goodwill and intangible assets make up most of the assets of RE (see paragraph 3.34).

Proposed merger with Wolters Kluwer

3.11. In November 1997 a proposed merger between RE and Wolters Kluwer NV (Wolters Kluwer), a Dutch publishing company, was notified to the European Commission, which opened an in-depth investigation. The Commission decided to raise objections to the proposed merger on competition grounds and addressed a statement of objections to RE and Wolters Kluwer. RE told us that the parties had issued a reply, strenuously contesting the Commission's objections. Ultimately, the Commission was not required to take a final view because the parties announced in March 1998 that they had abandoned the merger.

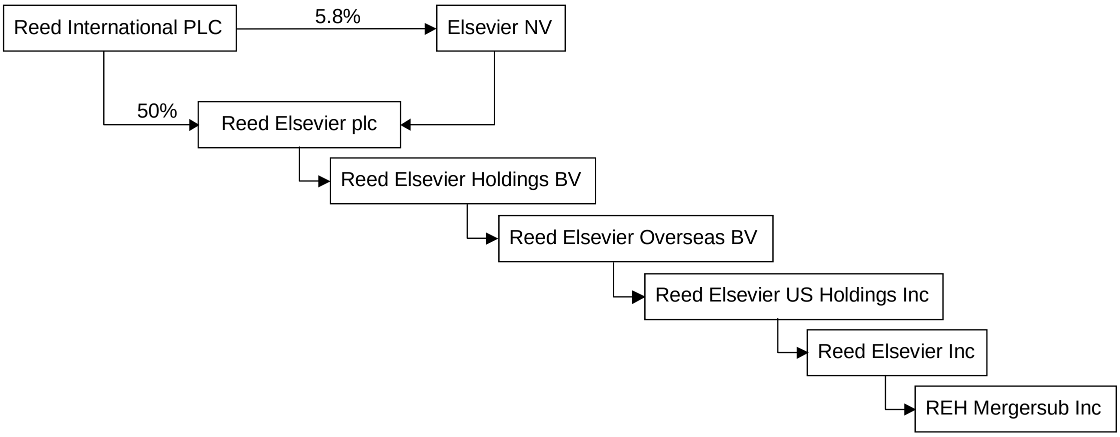
Corporate structure

3.12. Reed and Elsevier each hold a 50 per cent interest in RE. Reed holds a 39 per cent interest in Elsevier Reed Finance BV, with Elsevier holding a 61 per cent interest. Reed additionally holds a 5.8 per cent indirect equity interest in Elsevier. This equity interest has been taken into account in determining the equalization ratio whereby one Elsevier ordinary share is, in broad terms, intended to confer equivalent economic interests to 1.538 Reed ordinary shares. Under the equalization arrangements, Reed shareholders have a 52.9 per cent economic interest in 'Reed Elsevier', and Elsevier shareholders (other than Reed) have a 47.1 per cent economic interest. 'Reed Elsevier' is a collective reference to the separate legal entities of Reed International PLC, Elsevier NV, Reed Elsevier plc, Elsevier Reed Finance BV and their respective subsidiaries, associates and joint ventures. The financial information on RE in this chapter, including that in Tables 3.1 to 3.5, is based on the combined accounts of the Reed Elsevier businesses.

3.13. RE provided us with a chart showing in a simplified structure the entities relevant to the proposed Harcourt transaction, which is set out in Figure 3.1.

FIGURE 3.1

RE: partial corporate structure



Note: All companies are 100 per cent owned except where indicated.

3.14. The proposed transaction involving the acquisition of the entire issued share capital of Harcourt General, Inc, is being performed by the US corporation Reed Elsevier Inc and its wholly-owned subsidiary Mergersub. REI is a wholly-owned subsidiary of RE, owned via the intermediate holding companies, Reed Elsevier Holdings BV, Reed Elsevier Overseas BV and Reed Elsevier US Holdings Inc.

Business structure and principal activities

3.15. RE's business activities are organized into four segments: Science & Medical; Legal; Education; and Business. (In 2000 the results of the Education segment were reported separately from those of the Legal segment for the first time, but RE has given us restated figures for earlier years.)

3.16. RE measures and presents the profit performance of its businesses both before and after the effects of amortization of goodwill and intangible assets and exceptional items. Profits measures struck before the impact of these items are referred to as 'adjusted'. Table 3.2 shows RE's turnover and adjusted operating profit by business segment for the five years to 2000.

Science & Medical segment

3.17. The Science & Medical segment of RE comprises worldwide scientific and medical publishing and communication businesses. Elsevier Science publishes peer-reviewed primary research journals, secondary journals and information services (including abstracting and indexing products), tertiary or review journals, monographs, reference works (including encyclopaedias), and databases. Much of this material is made available on CD-ROMs or online, as well as in print. A description of the activities of Elsevier Science and of the other businesses within the Science & Medical segment is set out below:

- Elsevier Science is an international publisher of scientific information, with headquarters in the Netherlands and operations located around the globe. This scientific information business contributed approximately 85 per cent of the total turnover of the Science & Medical segment in 2000. Through several imprints including Elsevier, Pergamon, Excerpta Medica and North Holland, Elsevier Science supplies scientific information through journals, books, CD-ROMs and online through ScienceDirect to research libraries, scientists and professional customers serving an increasingly wide range of research fields. Elsevier Science publishes about 1,200 subscription-based journals with about 150,000 new research articles published each year. Of these, approximately 1,000 journals are peer-reviewed journals.

TABLE 3.2 **RE: turnover and adjusted operating profit by business segment, five years to 2000**

					£ million
	1996	*1997*	*1998*	*1999*	*2000*
Turnover					
Science & Medical:					
Elsevier Science			513	534	592
Medical businesses			109	118	101
			622	652	693
Legal:					
LEXIS-NEXIS US			741	854	947
LEXIS-NEXIS International			207	233	254
			948	1,087	1,201
Education:					
Reed Educational & Professional Publishing			159	181	202
Business:					
Cahners Business Information			531	542	665
Reed Business Information			248	243	270
Elsevier Business Information			257	270	278
Reed Exhibition Companies			274	301	358
OAG Worldwide	*Figures omitted.*		90	85	72
Other	*See note*		34	29	29
	on page iv.		1,434	1,470	1,672
Total			3,163	3,390	3,768
Adjusted operating profit					
Science & Medical			223	231	252
Legal			291	282	237
Education			31	34	40
Business			268	245	264
Total			813	792	793
					per cent
Adjusted operating margin					
Science & Medical			35.9	35.4	36.4
Legal			30.7	25.9	19.7
Education			19.5	18.8	19.8
Business			18.7	16.7	15.8
Total			25.7	23.4	21.0

Source: RE.

- ScienceDirect, Elsevier Science's online platform for dissemination of its STM journals contains full text articles from all Elsevier Science's journals since 1995. ScienceDirect also contains certain reference works and databases published by Elsevier Science. The ScienceDirect product line includes other subject-specific online products, such as PhysicsDirect, PharmaDirect, EngineeringDirect, Embase.com and Biomednet reviews. Elsevier Science recently launched Scirus.com, an Internet browser product tailored towards scientific information. It is a stand-alone product, which is freely available independently of ScienceDirect. Scirus.com allows for simultaneous searches through more than 50 million web pages as well as the ScienceDirect content. The CrossRef system, to which Elsevier Science is a party, permits users to navigate seamlessly between the primary content to which they subscribe, irrespective of the publisher.

- In addition to primary research journals, Elsevier Science publishes secondary material (bibliographic data, indexes and abstracts), and tertiary information products (review and reference works). It also publishes conference proceedings, letters, journals for rapid communications, handbooks, bulletins, magazines, dictionaries, newsletters and sponsored publications.

- Elsevier Science offers most of its secondary material in the form of databases, available electronically online or on CD-ROM. These include: Embase (pharmaceutical and biomedical records); Compendex (engineering records) and Beilstein (organic chemical structures).

- Elsevier Science includes two USA-based software businesses which do not carry out global STM publishing activities: Endeavor Information Systems is a provider of software systems for libraries and digital collections management; MDL Information Systems provides information management systems for chemical and scientific data.

3.18. In 2000, approximately 43 per cent of Elsevier Science's turnover was derived from North America, 26 per cent from Continental Europe, 7 per cent from the UK, and the remaining 24 per cent from the rest of the world.

3.19. RE's Science & Medical segment also includes:

- *Excerpta Medica Communications* (EMC) which publishes customized information to healthcare professionals, medical societies and pharmaceutical companies worldwide. EMC fulfils the needs of pharmaceutical companies' international and domestic marketing operations through a global network of offices. Activities include educational and promotional scientific information delivered via medical symposia, traditional print media, audio-visual and computer-based programs. EMC works closely with pharmaceutical companies to provide worldwide marketing platforms for new drugs.

- *Éditions Scientifiques et Médicales Elsevier* (ESME) based in Paris, publishes 79 medical, biotechnology and clinical chemistry titles, primarily in French language.

Butterworth-Heinemann, which forms part of RE's Education segment (see paragraph 3.24), publishes professional books, including some technical and medical books which have STM content.

3.20. Table 3.2 shows that in the five years to 2000 the adjusted operating margin of the Science & Medical segment declined from 41.8 to 36.4 per cent. RE attributes this decline principally to a combination of high attrition, lower recent price increases and higher costs. Even so, its adjusted operating margin has remained higher than those of the other three segments.

3.21. The management accounts for Elsevier Science for 2000, include information on sales and trading profit by business unit, which is set out in Appendix 3.1, Table 1. The table shows that the margins on the primary journal businesses are [✂] than those for the other units in Elsevier Science.

Legal segment

3.22. Reed Elsevier's Legal segment includes companies that sell legal, tax, and business reference publications and information services throughout the world. It is organized into two principal divisions LEXIS-NEXIS US, which operates primarily in the USA, and LEXIS-NEXIS International, which is focused on non-US markets. With a turnover of £947 million in 2000, LEXIS-NEXIS US contributed approximately 79 per cent of the Legal segment's total turnover of £1,201 million.

3.23. LEXIS-NEXIS International comprises the Butterworths group of companies with operations in the UK, Canada, the Asia-Pacific region and South Africa and other businesses in Europe and South America. Butterworth Tolley in the UK is the most significant business and it provides legal, tax and regulatory materials in loose-leaf, book, CD-ROM and online formats. In partnership with a legal training firm, it provides online training and professional development. In 2000, approximately 73 per cent of the global turnover of the Butterworth companies came from the UK.

Education segment

3.24. Reed Educational & Professional Publishing (REPP) publishes educational and academic books and materials in the UK, USA, Australia, New Zealand and South Africa. It operates through eight main businesses: UK Schools publishes for the UK primary and secondary markets through the Heinemann, Rigby and Ginn imprints. Global Library publishes reference material for school libraries and has operational units in the UK, USA and Australia. Butterworth-Heinemann is an international publisher of professional information and learning materials for higher education and professional markets. In the USA, Rigby publishes supplemental materials for elementary school literacy development. Greenwood-Heinemann publishes monograph and reference lists and teachers' professional resources. The Australian business, Rigby Heinemann, is a publisher of primary and secondary school books in Australia. In South Africa, Heinemann is a publisher of school texts and in New Zealand, Reed Publishing publishes school textbooks for the local market.

3.25. In 2000, approximately 51 per cent of REPP's turnover was derived from North America, 31 per cent from the UK, 7 per cent from Australia, and the remaining 11 per cent from the rest of the world. With a turnover of £202 million it was much the smallest of RE's four segments but, following the proposed merger, it will be combined with Harcourt's much larger Education Group.

Business segment

3.26. The Business segment includes Cahners Business Information (Cahners), Reed Business Information (RBI) and Elsevier Business Information (EBI), which are active in the publication of business magazines, online services and information reference products. It also includes Reed Exhibition Companies (REC), an international trade show organizer.

3.27. The business magazine and information companies operate principally in the USA, Europe and Australia, and contributed approximately 79 per cent of the turnover of the Business segment in 2000. There are three businesses:

(a) *Cahners* is a publisher of business information in the USA, with more than 120 trade magazines and 120 web sites. Among Cahners' best known titles are: *Variety, Broadcasting & Cable, Multichannel News, Publishers Weekly, EDN, Interior Design* and *Design News.*

(b) *RBI* the UK-based business magazine and directory publisher, has a portfolio of around 100 business magazines, directories, market access products and online services. In 2000, approximately 81 per cent of RBI's turnover came from the UK. RBI publishes over 50 primary business magazine brands in some 20 market facing sectors. Its business magazines include: *Computer Weekly, Farmers Weekly, Estates Gazette, Flight International, New Scientist, Caterer & Hotelkeeper* and *Commercial Motor*. Its major directories are *Kelly's*, *Kompass* and *The Bankers' Almanac*, and it also offers a range of online services.

(c) *EBI* comprises the business and reference publishing operations in Continental Europe, which operates in the Netherlands, Belgium, Spain, Germany and France, and the Elsevier Tuition professional training business in the Netherlands.

3.28. The exhibitions business contributed approximately 21 per cent of the turnover of the Business segment in 2000. REC is an international event organizer with 450 events in 28 countries, attracting over 100,000 exhibitors and 5.5 million visitors annually. REC operates over 250 show-related web sites. In 2000 approximately 42 per cent of REC's turnover came from North America, 34 per cent from Continental Europe, 10 per cent from the UK and the remaining 14 per cent from the rest of the world.

Financial performance

3.29. On 30 November 2000 Reed and Elsevier announced an issue of new ordinary shares (described in paragraph 3.35). In its prospectus RE set out combined profit and loss account data for the five years to 1999. Table 3.3 shows these data updated for the results for 2000 to give the results for six years, and also showing the amounts of dividends paid and proposed each year. The amounts in the table for the financial years 1995, 1996 and 1997 have been restated to conform with the UK accounting standard FRS10—Goodwill and Intangible Assets, which was first applicable for 1998, to include retrospective capitalization and amortization of acquired goodwill and intangible assets.

3.30. In 1999 the parent companies reduced the dividend to shareholders by approximately one-third to channel cash resources into the £750 million investment programme that RE had announced. Table 3.3 shows that in three of the last four years RE's dividends exceeded the profit attributable to shareholders. This reflects the incidence of exceptional items, and the adoption of FRS 10 which introduced significant charges for the annual amortization of goodwill and intangible assets. [

Details omitted. See note on page iv.

]

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

TABLE 3.3 **RE: combined profit and loss account, 1995 to 2000**

£ million

	1995	*1996*	*1997*	*1998*	*1999*	*2000*
Turnover						
Continuing operations	2,724	2,897	2,987	3,163	3,390	3,768
Discontinued operations	925	484	430	28	-	-
	3,649	3,381	3,417	3,191	3,390	3,768
Adjusted operating profit						
Continuing operations	700	787	812	813	792	793
Discontinued operations	128	69	73	-	-	-
	828	856	885	813	792	793
Amortization of goodwill and intangible assets	(255)	(250)	(289)	(332)	(373)	(468)
Exceptional items charged to operating profit	-	-	(502)	(79)	(239)	(115)
Operating profit	573	606	94	402	180	210
Non-operating exceptional items	403	24	54	682	7	85
Profit before interest and taxation	976	630	148	1,084	187	295
Interest	(105)	(51)	(62)	(40)	(82)	(103)
Taxation	(185)	(212)	(99)	(271)	(167)	(159)
Minority interests and preference dividends	(1)	(1)	(1)	(1)	(1)	-
Profit attributable to shareholders	685	366	(14)	772	(63)	33
Ordinary dividends paid and proposed	(293)	(348)	(365)	(349)	(234)	(245)
Retained profit/(loss)	392	18	(379)	423	(297)	(212)
						per cent
Ratios to turnover						
Adjusted operating profit	22.7	25.3	25.9	25.5	23.4	21.0
Operating profit	15.7	17.9	2.8	12.6	5.3	5.6
Profit before interest and taxation	26.7	18.6	4.3	34.0	5.5	7.8

Source: RE.

3.31. RE provided the segment analysis shown in Table 3.4. It has been prepared to take proper account of discontinued businesses and so present data on a consistent basis throughout. The 1995 data include estimated allocations of the Reed Consumer Books businesses sold in 1997 and 1998 for which comparative data were not available.

3.32. Table 3.4 shows that more than half of RE's sales are to customers in North America, and that this proportion has been increasing while sales to customers in the UK, the Netherlands and other markets have declined as a percentage of turnover.

TABLE 3.4 **RE: analysis of turnover by geographical market, 1995 to 2000**

£ million

	1995	*1996*	*1997*	*1998*	*1999*	*2000*
Continuing operations:						
North America	1,458	1,523	1,582	1,726	1,906	2,152
UK	382	423	432	483	484	521
Netherlands	186	192	208	222	237	234
Rest of Europe	385	414	401	407	418	478
Rest of world	313	345	364	325	345	383
	2,724	2,897	2,987	3,163	3,390	3,768
Discontinued operations	925	484	430	28	-	-
	3,649	3,381	3,417	3,191	3,390	3,768
						per cent
Continuing operations:						
North America	53.5	52.6	53.0	54.6	56.2	57.1
UK	14.0	14.6	14.5	15.3	14.3	13.8
Netherlands	6.8	6.6	7.0	7.0	7.0	6.2
Rest of Europe	14.2	14.3	13.4	12.9	12.3	12.7
Rest of world	11.5	11.9	12.2	10.3	10.2	10.2

Source: RE.

3.33. Table 3.5 shows summary balance sheets for RE for the five years to 2000. As noted in paragraph 3.29, in 1998 RE adopted a new UK accounting standard, FRS 10—Goodwill and Intangible Assets, which it applied retrospectively.

TABLE 3.5 **RE: summary balance sheets, five years to 2000**

£ million

	1996	*1997*	*1998*	*1999*	*2000*
Goodwill and intangible assets	2,520	2,672	3,598	3,400	4,127
Other operating assets/(liabilities)	213	93	36	15	(49)
	2,733	2,765	3,634	3,415	4,078
Taxation	(239)	(187)	(297)	(364)	(427)
Dividend and net interest	(231)	(250)	(239)	(122)	(170)
Minority interests	(4)	(6)	(6)	(8)	(7)
Net assets	2,259	2,322	3,092	2,921	3,474
Equity (reserves and share capital)	2,063	1,692	2,130	1,855	3,041
Net debt	196	630	962	1,066	433
	2,259	2,322	3,092	2,921	3,474
					per cent
Debt:debt + equity	8.7	27.1	31.1	36.5	12.5

Source: RE.

3.34. Table 3.5 shows the increasing amounts of goodwill and other intangible assets arising from RE's acquisitions (see Table 3.1). It also shows that other operating assets have declined and were negative at 31 December 2000. RE told us that December was a very high cash flow month because of the receipt of annual subscriptions of scientific journals. A high proportion of its revenues, not only in Science & Medical but also in Legal in particular, was subscription based. RE also had a significant exhibition business, and the deposits for the shows that took place in the first quarter in the USA come in during the last quarter. So the year end was the highest point of the year in terms of cash. It then turned cash negative because it had collected the cash and then had to fulfil the service.

3.35. Table 3.5 also shows that its level of indebtedness was increasing until 1999, but that it declined in 2000. This decline resulted from the receipt, towards of the end of the year, of the proceeds of a share issue to fund the acquisition of Harcourt. A placing of new shares in Reed and Elsevier was undertaken jointly in November 2000 and new debt facilities were obtained. The placing of new shares in the parent companies gave net proceeds of £1,263 million, most of which was hedged into US dollars. The amount represented 9.9 per cent of the share capitals of both parent companies.

RE in the UK

3.36. RE has the following businesses in the UK:

Business	*Location*	*Turnover £m*	*Employees*
Elsevier Science UK	Oxford		
Butterworth Tolley	London		
LEXIS-NEXIS Europe	Oxford		
REP	Sutton	*Figures omitted.*	
REC	Richmond	*See note on page iv.*	
Cahners (UK)	London		
OAG	Dunstable		
RBI	Sutton		

In 2000 the total turnover of these companies was £[✂] million and a total of [✂] staff was employed (including [✂] in the RE head office).

Harcourt

3.37. Harcourt had its origins when Richard A Smith's father incorporated his movie theatre exhibition business under the name Mid West Drive In Theatres, Inc in 1950. In 1961 Richard A Smith succeeded his father as Chief Executive Officer of the company, a position which he held until 1 November 1999. Mr Smith remains as Chairman of Harcourt. The Smith family has retained control over the composition of the board of directors through its ownership of Class B Stock (see paragraph 3.62).

3.38. In 1964 the name of the company was changed to General Cinema Corporation (GCC). During the 1970s and 1980s it made several acquisitions. In 1987 the company acquired a controlling interest in the Neiman Marcus Group, Inc (NMG), which operates a chain of up-market department stores.

3.39. In March 1989, GCC sold its soft drink business to Pepsico, Inc for $1.8 billion. In November 1991 GCC acquired Harcourt Brace Jovanovich, Inc through an exchange of stock and the purchase of certain debt for about $1.1 billion. In 1993 it changed its name from General Cinema Corporation to Harcourt General, Inc. Since then Harcourt has turned itself into the company that it is today by engaging in numerous acquisitions and disposals. The larger transactions were:

(a) In December 1993 Harcourt spun off its theatre operations to GC Companies, Inc (GCX).

(b) In June 1994 it sold its insurance operation, Harcourt General Insurance, Inc to General Electric Capital Corporation for $442 million.

(c) In June 1997 Harcourt acquired National Education Corporation (NEC) for approximately $854 million. NEC held 82 per cent of Steck-Vaughn Publishing Corp (Steck-Vaughn), and in 1998 Harcourt paid about $40 million to acquire the remaining 18 per cent.

(d) In October 1998 Harcourt acquired Mosby, Inc (Mosby), a medical publisher, from the Times Mirror Company.

(e) In October 1999 Harcourt's controlling equity position in NMG was spun off in a tax-free distribution to its shareholders. Harcourt retained approximately 10 per cent of NMG's shares, but gave an undertaking to the Internal Revenue Service that it would dispose of them within five years of the distribution.

3.40. The Smith family has retained executive positions with some of the companies that have been spun off from Harcourt. Robert A Smith and his brother-in-law Brian J Knez both act as President and Co-Chief Executive Officers of Harcourt. They also acted as Co-Chief Executive Officers of NMG until 14 May 2001, when they became Vice Chairmen. Richard A Smith is Chairman of Harcourt, NMG and GCX.

Harcourt's businesses

3.41. Harcourt is a Delaware corporation with its principal offices in Chestnut Hill, Massachusetts, a suburb of Boston. In July 2000 the company had more than 100 subsidiaries, incorporated in various jurisdictions, both US domestic and foreign.

3.42. The tables in this section are based on those that Harcourt included in the information memorandum that it provided to potential purchasers of the company (see paragraph 3.65). The tables in the information memorandum gave actual results for each of the three years to 1999 and a forecast for 2000. Harcourt has updated the tables to reflect the actual results for 2000.

3.43. Harcourt is organized into four groups: Education Group; Higher Education Group; Corporate & Professional Services Group; and STM Group. The revenues and EBITDA (earnings before interest, tax, depreciation and amortization) of each group for the four years to 31 October 2000 are shown in Table 3.6.

TABLE 3.6 **Harcourt: profit and loss by business group, four years to 2000**

				$ million
	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Education Group	480.1	565.9	583.6	754.8
Higher Education Group	262.4	356.2	367.3	361.3
Corporate & Professional Services Group	294.2	418.3	499.2	547.0
STM Group	453.4	529.2	699.5	756.0
Inter-company eliminations	(8.4)	(7.7)	(7.0)	(10.9)
Harcourt Online	-	-	-	-
	1,481.7	1,861.9	2,142.6	2,408.2
EBITDA				
Education Group	143.7	175.1	190.3	261.3
Higher Education Group	49.1	75.2	84.8	88.3
Corporate & Professional Services Group	36.5	68.0	80.5	80.5
STM Group	128.2	144.9	190.9	225.1
Inter-company eliminations	9.2	(1.0)	4.3	(4.9)
Harcourt Online	-	-	(3.9)	(7.1)
Administrative expense	(19.6)	(18.1)	(21.3)	(26.3)
	347.1	444.1	525.6	616.9
Depreciation and amortization	(253.8)	(229.7)	(246.0)	(249.2)
Exceptional charges	(277.2)	-	-	-
EBIT	(183.9)	214.4	279.6	367.7
				per cent
Ratio to revenues				
EBITDA	23.4	23.9	24.5	25.6
EBIT	12.4	11.5	13.0	15.3

Source: Harcourt.

STM Group

3.44. In the year to 31 October 2000 Harcourt's STM businesses had sales of $756 million and EBITDA of $225 million. Table 3.7 shows the results of this group for the four years to 2000.

TABLE 3.7 **Harcourt STM Group: profit and loss by business, four years to 2000**

				$ million
	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Harcourt Health Sciences				
MD Consult				
AP				
Harcourt Publishers International				
Consolidation adjustments				
EBITDA				
Harcourt Health Sciences				
MD Consult				
AP		*Figures omitted.*		
Harcourt Publishers International		*See note on page iv.*		
Consolidation adjustments				
Corporate allocations				
Amortization of acquisition-related goodwill				
Depreciation and other amortization				
EBIT				

Source: Harcourt.

3.45. The table shows that Harcourt STM has two principal businesses:

(a) *AP* publishes 174 peer-reviewed journals, with particular focus on life, physical, social and computer sciences. It also publishes reference works and databases. Its IDEAL system provides AP content online and holds over 95,000 scientific research articles; and

(b) *Harcourt Health Sciences* (HHS) is the global leader in healthcare and medical publishing measured by sales. It publishes some 8,500 clinical reference works and 250 journals and handbook series, covering the full spectrum of primary medical research, clinical practice and allied healthcare. Recent acquisitions include Churchill Livingstone (1997) and Mosby (1998).

MD Consult, a separate company within HHS, is an online service providing clinical information to physicians and other healthcare professionals. In 2000 it recorded a profit of $[✂] on revenues of $[✂] million, following a loss of $[✂] million on revenues of $[✂] million in 1999.

3.46. The results of AP for the four years to 2000 are shown in Table 3.8. These figures do not include sales of AP publications outside the USA by HPI.

TABLE 3.8 **AP: profit and loss, four years to 2000**

$ million

	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Growth (%)				
Plate amortization				
Other cost of goods sold				
Gross profit				
Gross margin (%)				
Selling, general and administrative expenses				
Depreciation				
EBIT				
Operating margin (%)				
Depreciation and amortization				
EBITDA				
EBITDA margin (%)				
Capital expenditure				
Plate				
Other				
Internet spending				

Figures omitted.
See note on page iv.

Source: Harcourt.

3.47. HHS's results are shown in Table 3.9.

TABLE 3.9 **HHS: profit and loss, four years to 2000**

$ million

	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Growth (%)				
Plate amortization				
Other cost of goods sold				
Gross profit				
Gross margin (%)				
Selling, general and administrative expenses				
Depreciation				
EBIT				
Operating margin (%)				
Depreciation and amortization				
EBITDA				
EBITDA margin (%)				
Capital expenditure				
Plate				
Other				
Internet spending				

Figures omitted.
See note on page iv.

Source: Harcourt.

3.48. *Harcourt Publishers International* (HPI) is responsible for international distribution of Harcourt English-language products, as well as for the publication of adaptations, translations and local materials. HPI operates in 22 countries, with the majority of its 881 employees in the UK and Canada. The majority of its revenues are generated by sales of STM Group products, but as Table 3.10 shows, about 30 per cent of its revenues in 2000 were derived from products of the other three groups. The table also shows the non-US sales of other Harcourt business units.

TABLE 3.10 **Harcourt: international revenues by business, 2000**

$ million

	HPI	*Other business units*	*Total*
Education Group			
K-12 Education			
Steck-Vaughn			
Harcourt Trade Publishers			
Higher Education Group			
Harcourt College Publishers			
Harcourt Learning Direct			
Corporate & Professional Services Group			
NETglobal			
Assessment Systems, Inc			
The Psychological Corporation			
Drake Beam Morin			
STM Group			
HHS			
MD Consult			
AP			
Total international revenue			

Figures omitted.
See note on page iv.

Source: Harcourt.

3.49. The combined results of the businesses making up HPI for the four years to 2000 are shown in Table 3.11.

TABLE 3.11 **HPI: profit and loss, four years to 2000**

$ million

	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Growth (%)				
Plate amortization				
Other cost of goods sold				
Gross profit				
Gross margin (%)				
Selling, general and administration expense				
Depreciation				
EBIT		*Figures omitted.*		
Operating margin (%)		*See note on page iv.*		
Depreciation and amortization				
EBITDA				
EBITDA margin (%)				
Capital expenditure				
Plate				
Other				
Internet spending				

Source: Harcourt.

3.50. Harcourt also supplied us with a breakdown of its journal revenues by three geographic regions, USA, UK and Rest of world. The information was provided in pounds sterling (converted at £1 = $1.5141), and is summarized in Table 3.12.

TABLE 3.12 **Harcourt: journal sales by geographic region, 2000**

Division	*USA %*	*UK %*	*Rest of world %*	*Total %*	*Total £'000*
HHS					
HHS Europe					
AP UK					
AP US			*Figures omitted.*		
Total			*See note on page iv.*		
Total (£'000)					

Source: Harcourt.

Table 3.12 shows that [✂] per cent of Harcourt's journal sales revenues arose in the UK in 2000. UK journal sales of $[✂] million represented only [✂] per cent of Harcourt's worldwide turnover in the year to 31 October 2000 of $2.41 billion. Harcourt also told us that its total UK turnover was approximately $[✂] million, about [✂] per cent of its total turnover.

Education Group

3.51. The Education Group provides instructional material for kindergarten to grade 12 ('K-12') education. K-12 educational publishing in the USA is divided into 'basal', which is core textbooks, and 'supplemental'. It is also divided between adoption states, which use an adoption system through which the materials are approved by the states, and open states, which allow providers to sell materials directly to school districts.

3.52. Through two of its divisions, Harcourt School Publishers and Holt, Rinehart and Winston, the Education Group produces textbooks and an array of print and electronic materials. Steck-Vaughn provides supplemental educational material. Harcourt Trade Publishers publishes fiction and non-fiction for children and adults through its Harcourt and Harvest imprints. Nearly all of the Education Group's sales are within the USA.

3.53. The performance of the Education Group is summarized in Table 3.13.

TABLE 3.13 **Harcourt Education Group: profit and loss by business, four years to 2000**

$ million

	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Harcourt School Publishers				
Holt, Rinehart and Winston				
Steck-Vaughn				
Harcourt Trade Publishers				
Consolidation adjustments				
EBITDA				
Harcourt School Publishers				
Holt, Rinehart and Winston				
Steck-Vaughn		*Figures omitted.*		
Harcourt Trade Publishers		*See note on page iv.*		
Consolidation adjustments				
Administrative expense				
Amortization of acquisition-related goodwill				
Depreciation and other amortization				
EBIT				

Source: Harcourt.

3.54. The most profitable business in the Education Group is Harcourt School Publishers. The business has been successful in recent state adoptions, particularly in the three largest adoption states of Texas, Florida and California. Harcourt attributes the growth in its operating profit to gains in market share, higher gross margins from a change in product mix, and spreading its operating costs over an expanded sales volume.

Higher Education Group

3.55. The Higher Education Group consists of three businesses. Harcourt College Publishers provides educational materials for college and university markets under the Harcourt, Dryden, Saunders College and Holt, Rinehart and Winston imprints. Harcourt Learning Direct provides traditional and technology-based distance learning products for vocational and self-study programmes. Harcourt Higher Education is an online venture that is seeking degree-granting authority for its Internet-based learning offerings; it includes Archipelago Productions, a publisher of multimedia interactive products for online learning.

Corporate & Professional Services Group

3.56. There are four separate businesses in this group:

(a) *NETglobal* consists of the combined operations of NETg and Knowledge Communication, Inc (KCI). NETg provides technology-based training materials for IT personnel while KCI provides professional development and business skills training.

(b) *Assessment Systems, Inc* (ASI) develops and administers computer-based examinations and related services for the state regulatory licensing, professional certification and corporate employment testing market.

(c) *Drake Beam Morin* (DBM) has offices in 43 countries. DBM's principal offering is in the area of outplacement services, but also advises on employee selection and executive compensation.

(d) *The Psychological Corporation* is a leading company in assessment and testing products and services for clinical, educational and professional use. It is best known for its norm-referenced, standardized tests, including the Stanford Achievement Test, taken by over 15 million high school students annually. Harcourt Educational Measurement offers aptitude and achievement tests for the K-12 market. The Psychological Measurement Group provides psychological, speech and occupational therapy tests. Its leading product is the Wechsler Intelligence Scales, the most widely used intelligence tests in the world.

3.57. The Psychological Corporation is to be retained by RE. Its results for the last four years are set out in Table 3.14.

TABLE 3.14 **The Psychological Corporation: profit and loss, four years to 2000**

				$ million
	Years ended 31 October			
	1997	*1998*	*1999*	*2000*
Revenues				
Plate amortization				
Other cost of sales				
Gross profit				
Selling, general and administrative expenses		*Figures omitted. See note on page iv.*		
Depreciation				
EBIT				
Depreciation and amortization				
EBITDA				
				per cent
Ratio to revenues				
Gross profit				
EBITDA		*Figures omitted. See note on page iv.*		
EBIT				

Source: Harcourt.

Financial performance

3.58. Table 3.15 shows the sales and operating profit of each of Harcourt's businesses for 2000.

3.59. It can be seen from the table that the businesses that are to be retained by RE (the STM Group, the Education Group and The Psychological Corporation) accounted for [✄] per cent of Harcourt's sales and [✄] per cent of its operating profit in 2000.

TABLE 3.15 **Harcourt: sales and operating profit by business, 2000**

	Sales $'000	*Operating profit $'000*	*Operating margin %*	*Share of sales %*	*Share of operating profit %*
Education					
Harcourt School					
HRW School					
Steck-Vaughn					
Harcourt Trade					
Consolidation adjustment					
Higher Education					
College Publishers					
Harcourt Learning Direct (ICS)					
Archipelago					
Professional Education					
Consolidation adjustment					
Corporate & Professional Services					
Psychological Corporation					
ASI					
NETg					
DBM					
KCI					
Consolidation adjustment					
STM Group					
HHS					
MD Consult					
AP					
Spain					
Asia					
Europe					
Toronto					
Montreal					
Japan					
Australia					
Consolidation adjustment					

Figures omitted.
See note on page iv.

Source: Harcourt.

Harcourt's UK interests

3.60. Harcourt has four active UK subsidiaries:

(a) *Harcourt Publishers Ltd* operates Harcourt's international headquarters in London and a UK distribution centre in Foots Cray. In September 2000 it accounted for 459 out of Harcourt Publishing International's 855 employees.

(b) *NETG Ltd* is part of the NETglobal IT training material business described in paragraph 3.56*(a)*, and also to be sold on to Thomson.

(c) *Drake Beam Morin Ltd* is part of the DBM recruitment and outplacement business (see paragraph 3.56*(c)*), that will be sold on to Thomson.

(d) *Mosby International Ltd* is part of the Mosby medical publishing business acquired from Times Mirror in 1998, which Harcourt cannot integrate with its other subsidiaries (see paragraph 3.39*(d)*).

Share capital

3.61. On 27 October 2000, the issued share capital of Harcourt was made up of three classes of equity securities:

(a) *Common Stock:* There were 55,049,581 issued shares of Common Stock.

(b) *Class B Stock:* The Class B Stock is not transferable except to members of the Smith family and related entities, but is convertible at any time on a share-for-share basis into Common Stock. Under certain circumstances, the holders of Class B stock have the right to cast ten votes per share for the election of directors. There were 18,111,768 outstanding shares of Class B Stock.

(c) *Series A Cumulative Convertible Preferred Stock:* Each share of Series A Stock is convertible into 1.31 shares of Common Stock.

3.62. The family interests of Richard A Smith have a controlling interest in Harcourt. The 18,097,180 shares of Class B Stock held by the Smith family constitute 99.9 per cent of the outstanding Class B Stock and, together with 2,057,549 shares of Common Stock owned by the Smith Family Group, constitute 27.2 per cent of the aggregate of the shares of the Class B Stock, Common Stock and Preferred Stock outstanding as of 27 October 2000 (assuming conversion of all Preferred Stock into Common Stock). In any election in which the Class B Stock carries one vote per share, the Smith Family Group had, as of 27 October 2000, 27.5 per cent of the combined voting power of the Common Stock and Class B Stock. In elections in which the Class B Stock carried ten votes per share, the Smith Family Group had 77.5 per cent of the combined voting power. The effect of this is to permit the Smith Family Group to exert decisive control over the results of elections for the board of directors in the event of a substantial accumulation of Common Stock by persons unrelated to the Smith family.

The proposed merger

Harcourt's sale process

3.63. By early 2000 Harcourt was finding that over the past few years there had been significant changes in the educational publishing industry and that the pace of those changes had accelerated over the past year. These changes included the effects of industry consolidation and accelerated technological changes, and they raised difficult strategic choices for Harcourt's management. There were challenges in protecting its traditional core businesses while investing in emerging online market opportunities. Management believed that it was at an increasing disadvantage in its ability to make such investments, given its relatively small market capitalization compared to its competitors. It acknowledged that the spin-off of NMG had not yet resulted in the expected increase in the earnings multiple of Harcourt's common stock with its attendant benefits in using the company's shares for acquisitions.

3.64. On 24 May 2000 Harcourt held a meeting of its board of directors to review the strategic issues facing the company and to consider exploring all strategic alternatives. The Co-Chief Executive Officers said that a sale price could reflect the intrinsic value of the company better than its market price over the next few years. The company's investment bankers outlined possible approaches for soliciting proposals from potentially interested parties if the board decided to explore a sale of all or a portion of the company.

3.65. At a further meeting on 16 June, management and the investment bankers updated the board on their work in exploring strategic alternatives, including a sale of the company. The board agreed to contact third parties and three days later Harcourt made a public announcement. The investment bankers contacted 63 companies that it saw as potential purchasers of all or part of Harcourt and sent copies of an information memorandum to 31 of them, including RE and Thomson.

3.66. At the same meeting the Compensation Committee of the board (which did not include members of the Smith family) put forward proposals for incentives to be offered to management and employees in connection with the exploration of strategic alternatives, including incentive packages for Messrs Knez and Smith and other members of management. Among other resolutions, the officers of the company were authorized to enter into the termination protection agreements approved by the committee.

3.67. On 18 August Harcourt received preliminary indications of interest from four parties for the acquisition of the company as a whole, and from eleven parties for the acquisition of various segments of the company. Among the parties expressing an interest in all the company were RE, Thomson and a buyer organized by a group of financial buyers, referred to by Harcourt as the ‘financial buyer’. Representatives of those interested parties that had been selected for the second round of bidding then conducted due diligence investigations, and the management of Harcourt made presentations to them. Final bids were invited for all or portions of the company by 12 October.

3.68. In early October Thomson informed Harcourt’s investment bankers that it was no longer prepared to bid for the whole company but wished to acquire some of its assets, while RE informed them that it intended to acquire the entire company and resell certain portions of it. To minimize its risk from the resale, RE stated that it wished to arrange it before it finalized its bid from Harcourt. Harcourt agreed to grant Thomson and RE permission to coordinate efforts with each other to facilitate such a resale.

3.69. On 11 October GCX, which had been spun out of Harcourt in 1993 (see paragraph 3.39*(a)*), filed for Chapter 11 bankruptcy. Harcourt announced that it expected to record an exceptional loss of $100 million (about $1.38 per share) to cover potential losses from Harcourt’s secondary liability for some of GCC’s lease obligations. The due date for final bids was postponed to 16 October.

3.70. Harcourt received final bids for the whole company from RE and the financial buyer. Two bids were also received for different portions of the company, but on a combined basis they would have led to the sale of only part of the company.

3.71. On 25 October RE submitted a revised offer. On 26 October the board of directors met, following negotiations between the parties. The company’s financial advisers gave a presentation that analysed the financial aspects of the offers received by the company, its current strategic plan and the other strategic alternatives available to the company. The Chairman noted that high levels of capital expenditures would be needed to reach the projected strategic plan and the detrimental effect that this would have on earnings per share. The board requested that the financial advisers render an opinion as to whether the transaction proposed by RE was fair from a financial point of view. After their presentation, they delivered an oral opinion, subsequently confirmed in writing, that the offer of $59.00 per common share was fair to the holders of these shares. The board resolved that it was advisable and in the best interests of the company and its stockholders to enter into the merger agreement. The agreement was signed on 27 October.

RE’s bid for Harcourt

3.72. When Harcourt was put up for sale in June 2000, RE saw it as attractive. In presenting a preliminary overview it was noted that the Harcourt opportunity was significantly positive for RE for the following reasons:

(a) sustainable value of brands, content, market position;

(b) fourth leg of scale achieved in Educational (Schools);

(c) fifth leg of scale achieved in Medical/Healthcare; and

(d) strong additional extension of Elsevier Science in core STM.

On 7 August the directors of RE agreed to send a non-binding letter of intent.

3.73. In September RE and its advisers carried out due diligence in Boston and New York, which included management presentations, meetings and access to data. It estimated that acquiring the Harcourt STM activities would add ([*Details omitted. See note on page iv.*]) approximately $[✂] million (or about [✂] per cent) to Elsevier Science’s 2000 turnover, as shown in Table 3.16.

TABLE 3.16 **Pro forma 2000 turnover of merged STM activities**

	$m
Sci-Tech division	
Harcourt	
AP	
Elsevier Science	
Life Sciences (excluding Clinical Medicine)	
Physics & Chemistry	
Social Sciences	
ScienceDirect/Endeavor	
ES London (excluding *The Lancet*)	
SPD	
Engineering Information	
ChemWeb	
MDL/Beilstein	
Pro forma Sci-Tech division	
Medical division	✂
Harcourt	
HHS	
MD Consult	
Elsevier Science	
Clinical Medicine (currently included in Life Sciences)	
Excerpta Medica Group	
ESME, France (primarily medical)	
The Lancet (currently included in ES London)	
FDC, drug regulations (based in USA)	
Pro forma Medical Division	
STM total	

Source: RE.

3.74. The table shows that Elsevier Science's existing business is mostly in Sci-Tech and that the addition of AP in 2000 would have led to an increase in turnover of [✂] per cent (after the re-organization into divisions). Conversely, Harcourt's STM business is predominantly medical, and the addition of Elsevier Science's medical businesses would increase 2000 turnover by [✂] per cent.

3.75. In early October the board of RE considered a definitive offer for Harcourt. It concluded that the company should acquire two major elements of Harcourt:

(a) *STM:* This business, through AP, would significantly expand Elsevier Science's existing academic publishing activities. HHS would provide Elsevier Science with a leading position in medical publishing, a complementary area. There were significant opportunities for accelerating growth through integration with Elsevier Science, reorganization of the medical businesses, investment in new product development and online migration. The compound annual growth rate from 2001 to 2005 of the entire Harcourt STM business was projected at [✂] per cent for revenues, and [✂] per cent for operating profit.

(b) *Educational and Testing:* Acquisition of the K-12 basal and supplementary educational and testing businesses of Harcourt would establish RE in a strong position in US English-language educational and schools publishing. This would complement RE's existing non-US English-language educational publishing and would provide a significant fourth leg to RE's holdings. These businesses had shown excellent performance under strong and consistent management. The compound annual growth rate for 2001 to 2005 was projected at [✂] per cent for revenues and [✂] per cent for operating profit.

3.76. The remaining Harcourt businesses in higher education and corporate training and services were less strategically attractive. For RE, a straight bid for either or both of STM and Educational would be preferred. But, because of the tax leakage on a piecemeal breakup, Harcourt would need a significant premium before such an approach yielded higher net proceeds than from selling the shares outright. RE would be in a much stronger position bidding for the entire Harcourt business and then selling on (preferably, by pre-agreement) the other businesses. The on-sale should not present any major difficulties. The board discussed the negotiations with Thomson for the on-sale of certain businesses immediately following closing and resolved that concluding such a contract was a precondition to an offer.

3.77. Reporting the results of its due diligence, it was noted that the change-of-control parachute plan for [✂] managers in central positions and for [✂] persons in operating businesses (see paragraph 3.66) would cost around $[✂] million. The residual lease obligations of GCC amounted to about $[✂] million, and there were some tax exposures. The amounts of the golden parachute payments [*Details omitted. See note on page iv.*] and, RE told us, these matters had been taken into account when formulating its offer. RE also told us that the Smith family had subsequently agreed to reduce the exposure of Harcourt to GCC leases by paying up to $[✂] million once Harcourt had paid $[✂] million.

3.78. The board noted that, once over 50 per cent of Harcourt's shareholders had accepted the offer, it would be possible to acquire the shares of the remaining shareholders at the offer price. [*Details omitted. See note on page iv.*]

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

The merger agreement with Harcourt

3.80. On 27 October 2000, an agreement was made between Mergersub, its immediate parent company REI, and Harcourt. Mergersub agreed to make an offer to the stockholders of Harcourt for all outstanding Common Stock at $59.00 per share and all outstanding Series A Cumulative Convertible Preferred Stock at $77.29 per share (each share of the stock is convertible into 1.31 shares of Common Stock and 1.31 × $59.00 = $77.29).

3.81. The agreement provides that as soon as practicable after the purchase of shares pursuant to the offer and the satisfaction or waiver of various conditions, Mergersub would be merged with and into Harcourt. The separate existence of Mergersub would then cease and Harcourt would continue as the surviving corporation with REI as its immediate parent company.

The sale and purchase agreement with Thomson

3.82. Thomson told us that in, the course of the auction process, it had evaluated Harcourt's portfolio of assets to determine which businesses would most fully complement its existing businesses. It had concluded that the Higher Education Group and parts of the Corporate & Professional Services Group presented a natural fit. Thomson had discussed with Harcourt's financial advisers its interest in joining with another buyer to purchase only certain assets and businesses of Harcourt, and was directed to RE.

3.83. On 27 October 2000 REI entered into an agreement (the sale and purchase agreement) with Thomson to sell for a total price of $2.06 billion in cash various subsidiaries and assets of Harcourt that made up Harcourt's Higher Education Group and its Corporate & Professional Services Group (except for The Psychological Corporation).

3.84. There are complex provisions for allocating Harcourt's liabilities, including tax liabilities, and its assets between the businesses sold to Thomson and those retained by RE. Under a separate transitional services agreement, RE agreed to continue to provide central support function services for one year in return for a fee based on Harcourt's budgeted Group Service Cost for 2001.

RE's tender offer

3.85. On 8 November Mergersub, pursuant to the merger agreement, launched a cash offer to the stockholders of Harcourt for all outstanding Common Stock at $59.00 per share and all outstanding Series A Cumulative Convertible Preferred Stock at $77.29 per share. The offer is subject to customary conditions, including tender of a number of shares of Common Stock which, together with any shares owned by RE, represent at least a majority of voting power of Common Stock of Harcourt on a fully diluted basis. The amounts payable under the tender offer are set out in Table 3.17, based on shares outstanding at 26 October 2000.

TABLE 3.17 **Amounts payable under tender offer by share class**

	Issued	*Held in treasury*	*Unexercised options*	*Total*	*Price per share $*	*Cost $m*
Common Stock	55,049,531	(2,276,750)	3,289,353	56,062,134	59.00	3,307.7
Series A Preferred Stock	775,713	0	0	775,713	77.29	59.9
Class B Stock	18,111,768	0	0	18,111,768	59.00*	1,068.6
						4,436.2

Source: RE.

*Following conversion into Common Stock.

Harcourt told us that some of the Class A Preferred Stock had been converted and some outstanding options had been exercised since the merger agreement was signed on 27 October.

3.86. The offer document explained that:

- If holders of B Stock wished to participate in the offer, they must first convert it into Common Stock.
- The Smith family had agreed to convert their Class B Stock (see paragraph 3.62) into Common Stock and to tender those shares in the offer. Class B Stock held by others that was not tendered would be automatically converted immediately before the consummation of the offer.
- If the merger took place, all Common Stock and Series A Cumulative Convertible Stock not owned by RE would be cancelled and converted into a right to receive the same amount of cash per share as the holder would have received had he tendered it.

3.87. The offer period was initially 20 business days. There is provision for it to be extended, but not beyond 270 days from 27 October (24 July 2001). The period has been extended several times. When announcing the latest extension to 4 June 2001 on 4 May 2001, RE explained that the offer was being extended to accommodate the continuing regulatory review in the UK and the USA and that it might be extended further in due course.

Funding of the merger

3.88. RE told us that the net cost of the businesses that it would retain would be approximately $4.5 billion (£3.1 billion), after taking into account $1.2 billion (£0.8 billion) of estimated Harcourt net debt at 31 October 2000, $0.3 billion (£0.2 billion) of Harcourt corporate liabilities and the on-sale to Thomson, including taxes payable.

3.89. RE told us that in order to fund the acquisition, a placing of new shares in Reed and Elsevier was undertaken jointly in November 2000 which raised £1,263 million (see paragraph 3.35). The remainder of the transaction cost was to be funded by available debt facilities, which included $6.5 billion of new bank facilities put in place in November 2000. Proforma combined net borrowings of RE (as at 31 December 2000) and Harcourt (as at 31 October 2000), taking into account the acquisition financing and the on-sale of businesses to Thomson, would be approximately £3.2 billion.

CC jurisdiction

3.90. Harcourt's assets at 31 October 2000 are shown in Table 3.18.

TABLE 3.18 **Harcourt: assets at 31 October 2000**

	$m	*£m**
Current assets	919.5	633.2
Property and equipment, net	125.3	86.3
Other assets:		
Prepublication costs, net	391.0	269.3
Investment in NMG	185.2	127.6
Goodwill, net	1,358.6	935.6
Other intangible assets, net	42.5	29.3
Other	57.7	39.6
	3,079.8	2,120.9

Source: Harcourt.

*At 31 October 2000 exchange rate £1 = $1.4521.

3.91. We are required to consider whether either the share of supply test or the assets test (embodied in paragraphs *(a)* and *(b)* respectively of section 64(1) of the Fair Trading Act 1973) is satisfied. The assets test is satisfied if the gross value of worldwide assets taken over exceeds £70 million. It can be seen from Table 3.18 that the value of Harcourt's assets was more than £2 billion at 31 October 2000. RE and Harcourt confirmed that the gross value of the assets that would be retained by RE exceeded £70 million.

3.92. RE told us that the merger transaction did not fall within the financial thresholds of the European Community Merger Regulation (ECMR). The parties had entered into a binding agreement on 27 October 2000, which was the triggering event for the purposes of the ECMR. To come within the primary thresholds at least two of the undertakings concerned in the concentration have to have EC-wide turnover of more than €250 million. To come within the secondary thresholds, at least two of the undertakings in the concentration have to have a turnover in each of at least three member states of more than €25 million. RE passed on to us information on 1999 turnover that Harcourt had provided to it to assess the applicability of the ECMR, which is set out in Table 3.19. These turnover figures include sales for the businesses that RE has committed to sell to Thomson.

TABLE 3.19 **Harcourt: EC turnover by member state, 1999**

	$m	*€m**
UK	90.4	84.8
Netherlands	27.8	26.1
Germany	16.3	15.3
France	13.1	12.3
Italy	12.4	11.6
Others (all less than €10m)	30.8	29.0
	190.8	179.1

Source: RE from Harcourt data.

*Converted at 1999 average rate €1 = $1.06578.

3.93. Harcourt's EC turnover was below €250 million, so the primary threshold (Article 1(2) ECMR) was not reached. Further, the secondary thresholds in Article 1(3) were also not satisfied, because Harcourt's turnover exceeded €25 million in only two member states.

Action by other competition authorities

3.94. The proposed merger was notified to relevant competition and antitrust authorities in the USA, the UK, Ireland, Germany, Austria and Brazil. The Irish authority concluded that the transaction was not notifiable under its Mergers and Takeovers (Control) Acts 1978 to 1996. Those in Austria, Germany and the USA have all issued clearances unconditionally. The investigation by the competition authorities in Brazil is continuing, but the transaction can be completed pending clearance.