

Part II

Background and evidence

3 The companies and the merger

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Introduction

3.1. In this chapter we deal with the financial performance of the companies involved in the merger, the financial aspects of the acquisition by Ladbroke of the Coral betting business on 31 December 1997, and the performance of other leading bookmaking firms. We then compare the performance of the bookmaking industry leaders, and analyse how the punter's pound bet is allocated between return of stakes and winnings to punters, external industry levies and retained profit. Finally we deal with the performance of SIS and BAGS, in both of which the parties involved in the merger had a strategic interest.

Ladbroke

3.2. Ladbroke originated as a betting business in the village of Ladbroke in Warwickshire in the 19th century. The original business was founded by a local trainer operating as a commission agent. The business moved to London at the turn of the century and grew organically into a large betting firm. This business became the Ladbroke Group following the legalization of off-course cash betting in the early 1960s and was floated on the London Stock Exchange in 1967. At 20 July 1998 it had a market capitalization of £3.8 billion and a price:earnings ratio of almost 23 and was one of the companies in the FT 100. Ladbroke has two divisions: the hotel division and the betting and gaming division. It operates within the worldwide hotel and hospitality industry under the brand name Hilton, and in the betting and gaming industries under the name Ladbrokes. The group, whose head office is located in Watford, employs some 42,000 people worldwide in approximately 50 countries.

3.3. The betting and gaming division includes retail betting, casinos and bingo and operates in 11 jurisdictions, including the UK. Ladbroke Racing UK is the part of the betting and gaming division which is responsible for UK retail betting.

3.4. Table 3.1 shows the five-year summary profit and loss account for Ladbroke to 1997. Turnover peaked at £4.4 billion in 1994, then fell back to £3.8 billion in the three latest years. Operating

profits were in the region of £250 million in the two years to 1994, fell to £218 million in 1995 due to the impact of the National Lottery, and increased to £272 million in 1997. The operating profit as a percentage of turnover was some 6 per cent for all years except 1997, when it increased to 7 per cent.

TABLE 3.1 Ladbroke: consolidated profit and loss account, 1993 to 1997

	Years ended 31 December					£ million
	1993	1994	1995	1996	1997	
Turnover	4,269	4,414	3,848	3,825	3,816	
Net operating costs	(4,020)	(4,168)	(3,630)	(3,595)	(3,544)	
Operating profit on ordinary activities	249	246	218	230	272	
Share of associated companies' profits and other income	1	2	(1)	3	4	
Exceptional items	(56)	(358)*	(25)	(102)†	(23)	
Profit/(loss) before interest	194	(110)	192	131	253	
Net interest payable	(143)	(120)	(96)	(72)	(50)	
Profit/(loss) on ordinary activities before taxation	51	(230)	96	59	203	
Taxation charge	(35)	(69)	(34)	(38)	(52)	
Profit/(loss) after taxation	16	(299)	62	21	151	
Dividends	(70)	(75)	(72)	(73)	(84)	
Retained earnings	(54)	(374)	(10)	(52)	67	
Operating profit after restating for amortization of goodwill	240	237	210	220	256	
Average employee numbers—betting and gaming	14,762	15,273	15,034	14,009	15,277	
Number of UK betting shops‡	1,918	1,894	1,876	1,819	1,896§	
						per cent
<i>Performance indicators summary</i>						
Turnover growth	2	3	-13	-1	0	
Operating profit as percentage of turnover	6	6	6	6	7	
Profit before interest as percentage of turnover	5	-2	5	3	7	

Source: Ladbroke.

*The 1994 exceptional items consisted of a £240 million provision on the disposal of the Texas retail operation, a £100 million provision against the Vernon pools business, £66 million revenue from termination of management contracts on the hotel business, reorganization costs of £53 million and other losses of £31 million.

†The 1996 exceptional items included £52 million for termination of the property division activity, £18 million loss on fixed assets, hotel division items of £15 million and extra provisions on the retail division disposal of £14 million.

‡Table 3.6 analyses betting shop activity and Table 3.20 shows Ladbroke's turnover per shop.

§Excluding Coral acquisition on 31 December 1997.

3.5. Ladbroke incurred exceptional charges of £358 million and £102 million in 1994 and 1996 respectively. These arose from disposals of retail and property activities and write-downs on non-betting activities. The effect in 1994 was a loss before tax of £230 million but other years showed profits which reached £95 million in 1995 and some £200 million in 1997.

3.6. The betting and gaming activity had between 14,000 and 15,300 employees over the five years, with overall falls in employee numbers in 1995 and 1996 followed by an increase of 9 per cent in 1997.

3.7. Table 3.2 shows Ladbroke's five-year summary balance sheet to 1997. The net operating assets were some £3.56 billion in 1993, fell to £2.5 billion by 1996 arising from disposals and write-downs, and increased to some £2.7 billion in 1997. Shareholders' funds, which were £2.1 billion in 1993, fell over the five years to £1.7 billion in 1997. If goodwill written off had been added back, shareholders' funds would have fallen from £2.3 billion in 1993 to £1.9 billion in 1996 before rising to £2.0 billion in 1997. The operating profit as a percentage of average net operating assets was 7 per cent for the three years to 1995 and increased to 11 per cent in 1997. Ladbroke drew our attention to the fact that the Hilton International brand carried a value in its balance sheet whereas the Ladbrokes brand did not. The value attributed to the Hilton International brand is in fact the cost that was attributed to it on its acquisition in 1987. Ladbroke said that it had made no attempt to value the Ladbrokes brand because it did not deliver any competitive advantage in terms of turnover or gross margin. We note in any event that accounting standards are more restrictive as regards the attribution of value to

internally generated intangible assets, which is how the Ladbrokes brand would have to be treated, than to acquired intangibles.

TABLE 3.2 **Ladbroke: consolidated balance sheet, 1993 to 1997**

	<i>£ million</i>				
	<i>As at 31 December</i>				
	1993	1994	1995	1996	1997
Tangible fixed assets	2,588	2,435	2,253	1,845	1,940
Intangible assets and investments*	921	823	714	761	958
Stock and debtors less creditors (excluding cash)	<u>48</u>	<u>93</u>	<u>(89)</u>	<u>(117)</u>	<u>(214)</u>
Net operating assets	3,557	3,351	2,878	2,489	2,684
Borrowings less cash	(1,349)	(1,377)	(1,023)	(708)	(583)
Dividend payable	(68)	(42)	(42)	(45)	(53)
Amount owing on Coral acquisition	-	-	-	-	(363)
Provisions	<u>(20)</u>	<u>(20)</u>	<u>(15)</u>	<u>(2)</u>	<u>(2)</u>
Shareholders' funds (as reported)	2,120	1,912	1,798	1,735	1,683
Add back goodwill written off (after amortization)	<u>171</u>	<u>171</u>	<u>155</u>	<u>171</u>	<u>312</u>
Adjusted shareholders' funds	<u>2,291</u>	<u>2,083</u>	<u>1,953</u>	<u>1,906</u>	<u>1,995</u>
<i>Performance indicators summary</i>					<i>per cent</i>
Operating profit as percentage of average net operating assets	7	7	7	9	11
Operating profit as percentage of reported average shareholders' funds	11	12	12	13	16
Adjusted operating profit as percentage of adjusted average shareholders' funds	10	11	10	11	13
Post tax profit/(loss) as percentage of adjusted average shareholders' funds	1	(14)	3	1	8

Source: Ladbroke published accounts and MMC analysis.

*The majority of this item represents the Hilton hotel brand name acquired in 1987 (£277 million) and the estimated current cost of betting licences (including those in the rest of Europe), which at 1997 amounted to some £600 million.

3.8. Table 3.3 shows the net operating assets of Ladbroke's UK bookmaking activities. At 31 December 1997 Ladbroke valued its betting shop licences at £440 million, which compares with a value of £377 million in 1996. Ladbroke acquired the A R Dennis betting shop chain of 114 shops for some £29 million in 1997. Moreover, in 1997 Ladbroke commenced a five-year shop refurbishment programme costing between £[30] and £[30] a shop (see also paragraph 6.35). It told us that it was planning to commence a capital programme to upgrade its EPOS systems. The investment would have negative cash flows totalling £[30] million over the first four years.

TABLE 3.3 **Ladbroke: balance sheet for UK betting and gaming activities (excluding Coral)**

	<i>£ million</i>	
	<i>As at 31 December</i>	
	1996	1997
Intangible assets—betting shop licences	377	440
Tangible assets	<u>86</u>	<u>88</u>
Valuation of betting shop estate*	463	528
Net working capital liability (excluding bank balances)	<u>-20</u>	<u>-41</u>
Net operating assets	443	487

Source: Ladbroke.

*Table 3.4 shows how the market value is calculated.

3.9. Ladbroke values its betting shops to take account of their use as LBOs.¹ It bands the shops into three ranges that produce respectively a net cash flow (contribution) above £[] each, between £[] and £[] each, and less than £[]. [] per cent of the shops fall into the top category. It then applies different multiples to the contribution from the shops in each range. The overall total valuation is then [*Details omitted. See note on page iv.*] as is shown in Table 3.4. Ladbroke told us that the [] was to ensure [] valuation of its portfolio.

TABLE 3.4 Ladbroke: valuation of shops at 31 December 1997 (excluding Coral)

Contribution	Number of shops	Average turnover per shop £'000	Average contribution per shop £'000	Valuation based on contribution for all shops £m
Greater than £[]	[]	Figures omitted. See note on page iv. 825*	65	[]†
Between £[] and £[]				
Less than £[]				
Totals or averages	1,902			

Source: Ladbroke.

*The average turnover per shop shown here is only for valuation purposes. This table excludes shops which were closed during the year, or which have not been valued because they are on football grounds. The turnover from these shops totalled some £[] million. If the total turnover from all shops is compared to the actual average shop numbers in 1997, the average would be £838,000 (see Table 3.20).

†The amount shown in Ladbroke's accounts at 31 December 1997 is £528 million, representing [*Details omitted. See note on page iv.*].

3.10. Of the [] per cent of shops which do not fall into the top category:

(a) [] per cent with average turnover of £[] ([] shops) showed []; and

(b) [] per cent with an average turnover of £[] ([] shops) made [*Details omitted. See note on page iv.*].

Table 3.4 suggests that the break-even point for a Ladbroke shop may be in the region of £450,000 to £500,000 turnover a year, although the position will vary according to other factors, such as premises costs (see also paragraph 3.57). Ladbroke provided us with an illustration of the contribution to be expected from what it described as a typical Ladbroke shop with turnover in the range £500,000 to £600,000, compared with a typical independent shop showing an annual turnover in each case of £555,000—the contribution was roughly £22,000 for both cases (see also paragraph 3.56).

3.11. Table 3.5 shows Ladbroke's performance attributable to separate activities over the five years to 1997. The retail betting activity showed turnover² in the region of £1.8 billion over the period, but there was a drop to £1.7 billion in 1995 reflecting the effect of the launch of the National Lottery at the end of 1994 and the subsequent introduction of National Lottery scratchcards in March 1995. Telephone betting turnover, which was £182 million in 1994, fell to some £143 million over the next two years but in 1997 increased to £227 million.

¹Throughout this chapter we refer to valuation of betting shop licences. Licences are not freely marketable but a shop operating with such a licence has an economic value which many companies in the industry reflect in their accounts.

²Unless otherwise noted, turnover denotes the aggregate amounts staked on bets before returns of customer winnings and stakes. The £1.8 billion turnover in 1997 is analysed in Table 3.6 and includes turnover from betting shops totalling some £1.6 billion and £200 million from betting activities in Europe.

TABLE 3.5 Ladbroke: performance by activity, 1993 to 1997

£ million

	Years ended 31 December				
	1993	1994	1995	1996	1997
<i>Turnover</i>					
Europe—retail betting*	†	1,784	1,715	1,765	1,804
Europe—telephone betting	†	182	145	143	227
The Americas	†	543	657	725	724
Casinos‡	†	7	31	38	40
Vernons	†	174	121	85	61
Total for betting and gaming		2,539	2,690	2,756	2,856
Discontinued activities (property and retail)		835	818	182	-
Hotels		895	906	997	960
Total turnover		4,269	4,414	3,848	3,816
<i>Operating profit</i>					
Europe—retail betting	†	52	34	60	87
Europe—telephone betting	†	26	6	5	6
The Americas	†	5	5	9	11
Casinos	†	2	7	5	4
Vernons	†	13	6	6	3
Total for betting and gaming		86	98	85	111
Discontinued activities (property and retail)		53	40	23	-
Hotels§		111	111	148	165
Total profit before tax and exceptional items		250	249	217	276
<i>per cent</i>					
<i>Operating profit as percentage of turnover</i>					
Europe—retail betting	†	2.9	2.0	3.4	4.8
Europe—telephone betting	†	14.4	3.9	3.7	2.6
The Americas	†	0.9	0.7	1.2	1.6
Casinos‡	†	19.1	26.3	13.9	10.1
Vernons	†	7.5	4.6	6.8	4.7
Total for betting and gaming		3.4	3.6	2.2	3.9
Discontinued activities (property and retail)		6.3	4.9	12.9	-
Hotels		12.4	12.2	13.6	17.2
Total profit		5.8	5.6	5.7	7.2

Source: Ladbroke published accounts.

*Turnover is the amount staked, before deducting customer winnings and return of stakes (except for the casino turnover—see ‡ below). The level reflects the recycling of winnings which inflates turnover.

†Not provided.

‡Casinos are not comparable to the other activities because casino turnover is the gross gaming win (ie after customer winnings), but turnover for the other activities is before these deductions. The casino operating profits are stated after gaming duty which for 1997 was approximately 18 per cent.

§The hotels profit is shown after deducting all central costs of some £15 million a year.

3.12. A comparison of operating profit margins for 1997 shows the return from retail betting activities (as a percentage of betting turnover) at 4.8 per cent, compared with 2.6 per cent for telephone betting and 1.6 per cent from US activities. The casino activity produced a return of 10 per cent, but this is a percentage based on gross gaming win, which is not comparable with the returns from the other betting activities. The Vernons pools activity showed a return of some 5 per cent (lower than in some earlier years). Betting and gaming activities overall showed a total operating profit for 1997 of £111 million, 40 per cent of total profits. Over the five years, the overall operating profit as a percentage of turnover ranged between 5.6 and 7.2 per cent.

3.13. Before acquiring Coral, Ladbroke had roughly 1,900 betting shops in the UK, generating average turnover of some £840,000 a shop and a gross margin¹ of some [§] per cent. We review the shop performance in greater detail in paragraphs 3.51 to 3.57.

¹Gross margin is turnover, net of return of stakes and winnings to customers, but before taking account of the incidence of betting duty and statutory and voluntary levies.

3.14. Table 3.6 shows a detailed breakdown of Ladbroke's betting and gaming activities for its financial year 1997. The betting shops turnover of £1.6 billion produced a gross margin of £[£] million ([£] per cent). The rate of return varies between the different types of betting activities with horses and greyhound betting, for example, showing similar returns of [£] and [£] per cent respectively, whereas football and numbers betting showed higher levels of return at [£] and [£] per cent respectively. The AWP machine takings (after payouts on winnings) totalled £28 million. Horse and greyhound betting activities accounted for 70 and 20 per cent respectively of UK betting shop turnover.

TABLE 3.6 Ladbroke: analysis of 1997 betting and gaming activities

	Turnover	£ million			per cent		
		Gross margin*	Duty and levies	Profit after costs	Gross margin	Duty and levies	Gross profit (after duty and levies)
<i>UK betting shops†</i>							
Horses	1,129	<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 5px;">{</div> <div style="text-align: center;"> <i>Figures omitted. See note on page iv.</i> </div> <div style="font-size: 4em; margin-left: 5px;">}</div> </div>	<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 5px;">{</div> <div style="text-align: center;"> <i>Figures omitted. See note on page iv.</i> </div> <div style="font-size: 4em; margin-left: 5px;">}</div> </div>				
Greyhounds	322						
Numbers	63						
Football	64						
Other sports etc	12						
AWP‡	<u>28</u>						
Total (excluding telephone betting)	1,618						
UK operating costs							
Profits on UK retail shops						81	
Ireland and racetracks	59					2	
Rest of Europe	<u>127</u>					<u>4</u>	
Per accounts	1,804					87	
<i>Telephone betting</i>							
UK	137						
Rest of Europe—Gibraltar	<u>90</u> 227					<u>6</u>	
<i>Other activities</i>							
USA, casinos and Vernons activities	<u>825</u>					<u>18</u>	
Table 3.5 total for betting and gaming	2,856					111	

Source: Ladbroke.

*The gross margin is calculated after deducting return of stakes and customer winnings but before deducting duty and levy payments.

†The average number of shops in 1997 was 1,896, compared with 1,819 in 1996.

‡AWP income is that from gaming machines in shops. Current legislation allows two machines in a betting shop. The income is the takings from the machines after customer payouts, and makes an important contribution to the overall profitability of betting shops. The figure is before direct operating costs, namely machine rentals and gaming machine licence duties, totalling £[£] million.

3.15. Ladbroke incurred betting duty and paid levies on the various betting activities in 1997. Together these totalled 8.2 per cent for horse betting, 7.3 per cent for greyhound betting and 6.7 per cent for numbers betting. The overall percentage representing the incidence of duty and levy payments was 7.8 per cent on all betting activities, representing 6.75 per cent betting duty and an average of some 1 per cent for levy. Ladbroke recovers the duty and levies from customers by way of payments which are either, at the customer's choice, added to the amount staked or deducted from the winnings. At present the percentage deduction is 9 per cent and Table 3.7 shows the analysis of Ladbroke's deductions and settlement of duty and levies for 1997/98. Ladbroke under-recovered on horse betting by £2.4 million but over-recovered £1.5 million from greyhound and football betting. Out of Ladbroke's total recoveries of £125 million for 1997, 64 per cent was added to stakes and 36 per cent was deducted from winnings.

TABLE 3.7 **Ladbroke: comparison of deductions for the year to March 1998 between betting categories**

	<i>£ million</i>					
	<i>Horses</i>	<i>Greyhounds</i>	<i>Numbers</i>	<i>Football</i>	<i>Others</i>	<i>Total</i>
Betting stake	[<i>Figures omitted. See note on page iv.</i>]					
Deductions paid on stake (a)*						
Total stake (turnover)						
Customer winnings						
Deductions on winnings (b)*						
Gross margin	<i>per cent</i>					
Gross margin as percentage of total stake	[<i>Figures omitted. See note on page iv.</i>]					
	<i>£ million</i>					
<i>Settlement of deductions</i>	[<i>Figures omitted. See note on page iv.</i>]					
Duty due on total stake†						
Levies due on total stake†						
Offset of total deductions ((a)+(b))						
Under-recovered/(over-recovered)	2.4	(0.7)	0.0	(0.8)	(0.2)	0.7
	<i>per cent</i>					
Under-recovered/(over-recovered) percentage of total deductions	2.5	(3.0)	0	(17.5)	(21.8)	0.6

Source: Ladbroke.

*Deductions are at 9 per cent.

†The rate of duty on all betting is 6.75 per cent of the monies staked. The levy for horse betting is 1.52 per cent, and the voluntary levy for greyhound betting is 0.4 per cent.

3.16. Ladbroke's betting shops contributed a profit of £[§] million (after deduction of duty and levies) and their overall operating costs totalled £[§] million ([§] per cent of turnover), giving an operating profit of £81 million (5.0 per cent).

3.17. Ladbroke's European telephone betting activity showed turnover of £227 million and contributed profits of almost £6 million. 60 per cent of this activity arose from UK betting but produced only [§] per cent of the profit.

3.18. Table 3.8 shows a breakdown of Ladbroke's advertising and marketing expenditures for the years 1994 to 1997. Advertising expenditure declined from £2.1 million in 1994 to £1.4 million in 1997. Expenditure on local promotional activity within Ladbroke's betting shops increased from £1.5 million in 1994 to £2.2 million in 1996 and £3.0 million in 1997, the 1997 expenditure representing an average expenditure of some £1,600 a shop. The overall advertising and marketing expenditure of £5.3 million in 1997 represented [§] per cent of the gross margin of £[§] million.

TABLE 3.8 **Ladbroke: advertising and marketing, 1994 to 1997**

	<i>£ million</i>			
	<i>Years ended 31 December</i>			
	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>
Advertising and media costs	2.1	1.5	1.5	1.4
Local promotional activity within LBOs*	1.5	1.6	2.2	3.0
Horse-racing sponsorship	0.3	0.3	0.2	0.3
Other costs†	<u>1.9</u>	<u>1.4</u>	<u>0.9</u>	<u>0.6</u>
	5.8	4.8	4.8	5.3

Source: Ladbroke.

*Includes point-of-sale material and other shop promotional costs.

†Includes central salaries, agency costs, public relations, greyhound sponsorship and other marketing costs.

Coral

3.19. Mr Joe Coral, the founder of Coral, started his activities in 1926 from a betting pitch at greyhound tracks. He opened a credit betting office in London in 1943 and, following the Betting and Gaming Act 1960, established a chain of off-course betting shops. In the 1970s the group expanded by adding two greyhound stadiums, social clubs, casinos, hotels and holiday camps (Pontins). At the end of the 1970s Coral lost its casino licences. This had a severe effect on its group profitability which led to its acquisition by Bass in January 1981. At that time Coral had 650 betting shops.

3.20. Bass integrated Coral into its operations but maintained the Coral brand name. In the 1980s Coral acquired some 180 UK shops, and a further 130 shops in the 1990s, and after closures of some 127 shops, its portfolio at 30 September 1997 totalled 833 shops in the UK. Coral also had betting shop activities in the Republic of Ireland and Jersey (58 shops in total). The Coral betting business immediately before it was sold to Ladbroke on 31 December 1997 is described in paragraph 3.26 and Appendix 3.1. The main interests, apart from LBOs, were Coral's telephone betting business, two greyhound tracks and an interest in SIS. At December 1997 Coral had some 5,400 full-time employees, of whom 4,100 were employed in shops, 650 in stadia operations, and the rest in corporate head office, telephone betting, Republic of Ireland and Jersey activities.

3.21. Table 3.9 shows Coral's profit and loss account summary for the three years to 30 September 1997. In 1996/97 Coral had an average of 840 licensed betting shops which generated £779 million of turnover and accounted for operating profit of £[≈] million before deduction of central support costs and Bass management charges. The overall operating profit as a percentage of turnover was [≈] per cent for 1996/97, which compared with [≈] per cent in 1994/95. The increase reflected the recovery in profitability following the adverse impact of the National Lottery launched at the end of 1994, and scratchcards introduced in March 1995. In 1996/97 Coral's turnover per shop averaged £927,000 compared with some £857,000 in 1995/96 and £898,000 in 1994/95.

TABLE 3.9 Coral: consolidated profit and loss account, 1995 to 1997*

	Years ended 30 September		
	1995	1996	1997
Average number of shops	738	862	840
	<i>£ million</i>		
<i>Turnover</i>			
UK shops	662.7	737.7	778.8
Other businesses†	103.0	105.7	113.7
Total turnover	<u>765.7</u>	<u>843.4</u>	<u>892.5</u>
Operating profit from shop activities	<div style="border: 1px solid black; padding: 5px; display: inline-block;"> <i>Figures omitted. See note on page iv.</i> </div>		
Profits from other business activities†			
Total operating profit			
Central support costs			
Bass group recharges			
Profit on ordinary activities before taxation	16.9	15.4	33.0
	<i>per cent</i>		
<i>Performance indicators summary</i>			
Turnover growth	‡	10.1	5.8
Total operating profit as percentage of turnover	[≈]
Profit on ordinary activities as percentage of turnover	2.2	1.8	3.7
Turnover per shop (£'000)§	898	857	927

Source: Due diligence report on Coral prepared on behalf of Bass by Deloitte & Touche.

*Bass did not prepare separate consolidated statutory accounts for Coral. The assets and liabilities of several companies have been aggregated to produce the figures shown in this table: see Appendix 3.1.

†Other businesses consist of telephone betting, stadium operations, Republic of Ireland and Jersey operations, and income from SIS dividends.

‡Not available.

§This includes Tote Direct turnover. It is not comparable with the turnover per shop figures shown in Table 3.20.

3.22. Coral's other businesses (including telephone betting) had a turnover of £114 million in 1996/97 compared with £103 million in 1994/95, and for 1996/97 contributed a profit of £[§] million compared with £[§] million in 1994/95.

3.23. Table 3.10 shows a summary of Coral's consolidated balance sheets in the years 1995 to 1997. Net operating assets increased from £[§] million at 30 September 1995 to £[§] million at 30 September 1997. The book value at 30 September 1995 reflected the acquisition of the 114 Arthur Prince shops in September 1995. Operating profit calculated as a percentage of average net operating assets increased from [§] per cent in 1996 to [§] per cent in 1997.

TABLE 3.10 Coral: consolidated balance sheets, 1995 to 1997*

		£ million		
		As at 30 September		
		1995	1996	1997
Intangible assets—value of betting shop licences†				[§]
Other fixed assets				
Total fixed assets				185.6
Working capital		[§]		
Net operating assets				[§]
Intercompany financing (net of cash balances)				[§]
Net assets‡				
		per cent		
Operating profit as percentage of average net operating assets		§	[[§]

Source: Due diligence report on Coral prepared on behalf of Bass by Deloitte & Touche.

*Bass did not prepare separate consolidated statutory accounts for Coral. The assets and liabilities of several companies have been aggregated to produce the figures shown in this table: see Appendix 3.1.

†Includes £[§] million for Arthur Prince shops acquired in September 1995.

‡The goodwill written off on the Arthur Prince acquisition was £[§] million.

§Not available.

3.24. Coral carried its shop businesses, including the licences, at a value of some £[§] million over the period. With the exception of the Arthur Prince business assets valued on acquisition at fair value of £[§] million, and £[§] million for shops in the Republic of Ireland,¹ the remaining portfolio is valued at cost. At each year end, the Coral management appraised the book value of the shop businesses by comparison with a value based on their discounted net cash flow. The company was able to give us this analysis only at September 1996 which showed a valuation of £[§] million based on [§], compared with a book value of some £[§] million (excluding shops in the Republic of Ireland).

3.25. In 1991 Coral commenced a programme of updating its shops from a green format to a blue format, and by September 1997, of some 830 UK shops, 337 had been updated to the latter format: this compares with 234 shops in 1995 out of a total of some 740. [

Details omitted. See note on page iv.

]

The merger

3.26. By an agreement made on 31 December 1997 between Bass and Ladbroke, Bass agreed to sell and Ladbroke agreed to purchase the Coral betting business. The consideration was £372 million, subject to adjustment. Completion of the agreement occurred on the same day. The Coral betting business included some 830 UK off-course betting shops, Coral's telephone betting service, Coral's on-course and sports betting activities, two greyhound stadia (Hove and Romford), Bass's shareholding in SIS, and Bass's shareholdings in Tote Direct and Lucky Choice Limited. Details of the assets that

¹Bass wrote down the value by some £[§] million because it contemplated the disposal of the Irish operations in 1995 and concluded that the write-down reflected a permanent diminution in their value.

were the subject of the agreement are set out in Appendix 3.1. The transaction followed a decision by Bass to put Coral up for sale after Bass failed to acquire the William Hill betting shops from Brent Walker in October 1997. Bass told us that as Nomura,¹ the ultimate purchaser of William Hill, had no business synergies and yet had paid significantly more than Bass offered, it must have taken a different view from Bass of the market and the opportunities. Bass therefore considered that it had a duty to its shareholders to explore the possibility of a disposal of Coral and to test its market value against the value available to Bass from its retention. A decision was therefore made to see how much would be offered for Coral, and Bass commenced an informal auction process.

3.27. Bass obtained confidentiality agreements from two venture capital investors and Nomura, in addition to Ladbroke, and received preliminary bids from these four parties. Ladbroke's bid was broadly 15 per cent higher than the other three. Bass offered Ladbroke a period of exclusivity until 31 December 1997 in order to complete the disposal negotiations. Bass told us that the main reasons for the sale to Ladbroke included the price, the lack of bid conditions and Ladbroke's perceived ability to complete the deal quickly.

3.28. The Coral sale included shares in SIS (see paragraph 3.26), in which Bass had a holding of almost 12 per cent. However, as there were pre-emption rights between shareholders, Ladbroke was only able to increase its holding in SIS by some five percentage points (see Table 3.24). After adjusting for those changes in shareholdings in accordance with the agreement, the net consideration paid by Ladbroke was £362.7 million. Ladbroke told us that, since the acquisition, Coral had not been integrated with the Ladbroke betting and gaming division pending the outcome of the competition authorities' scrutiny of the transaction and still operated from its Barking head office, but with a Ladbroke senior director in overall control to replace the Managing Director who had remained with Bass.

3.29. Ladbroke allocated the purchase consideration of almost £363 million to intangible assets of £153 million, tangible assets of £69 million, net working capital of £2 million and purchase of goodwill of £139 million. The intangible assets represent Ladbroke's estimate of the value of the Coral betting shop licences on a basis consistent with the valuation of its own licences. Ladbroke told us that this consistency of approach [*Details omitted. See note on page iv.*], as was the case with the Ladbroke licences. The resulting difference between consideration and fair value of assets acquired was treated as goodwill on acquisition and written off to reserves in Ladbroke's 1997 accounts.

3.30. Ladbroke noted that the Coral shops had on average a higher turnover per shop than its own portfolio [*⊗*] (see paragraph 3.54). Ladbroke considered that there was considerable scope for efficiency and other gains from the Coral acquisition. It expected the following financial gains from the Coral shops in the first and second years following the acquisition:

Details omitted. See note on page iv.

These savings, if achieved, would total £[*⊗*] million for year 1 and £[*⊗*] million for year 2, against which Ladbroke estimated that the forecast profit from Coral's telephone betting business of £[*⊗*] million in 1997/98 would be eliminated when the two telephone betting businesses were combined. Its expectation was that it would not be able to keep all the combined business because of the likelihood that a proportion of customers having accounts with both Ladbroke and Coral would seek alternative telephone betting opportunities with other providers.

¹William Hill is owned by The Grand Bookmaking Company Limited, which is in turn indirectly and beneficially owned by Nomura.

3.31. We calculated that the consideration paid by Ladbroke equated to a price:earnings ratio of 16, based on the original consideration of £372 million (subsequently adjusted to £362.7 million) and on Coral's historical profit before tax of some £33 million and an illustrative tax rate of 31 per cent. On the assumption that an increase in profits from Coral of £[§<] million a year could be sustained, the price:earnings ratio for the offer price would fall to roughly [§<] times. Ladbroke also described a number of further areas where it might be able to achieve financial gains as a result of the merger.

3.32. In addition to cash flow savings Ladbroke increased its shareholding in SIS by some 5 per cent, giving it a total interest of almost 23 per cent compared with a pre-merger interest of some 18 per cent. On the basis of SIS's total dividend payments in 1997 of almost £8 million, the incremental shares would generate dividends of some £400,000 a year. Ladbroke calculated that there would be an improved effect on its group reported profit by its ability, with a 23 per cent holding, to account for its share of attributable profits of SIS (£5.2 million on the basis of the 1997 results): see paragraph 3.71.

3.33. Ladbroke was confident of its ability to increase Coral's margins. It considered that it had better security procedures to protect against 'shrinkage' (ie loss of revenue arising from staff or customer dishonesty and human error), and it had previous experience of eliminating a [§<] per cent margin shortfall at the A R Dennis shops within 12 months of their acquisition. At the same time, however, Ladbroke had assumed that it would lose £[§<] million of Coral's betting shop turnover from the acquisition, and this would not affect its margin improvement plans noted in paragraph 3.30(a). Ladbroke calculated that its purchase of Coral was earnings enhancing.

3.34. Ladbroke told us it estimated that Nomura's purchase of William Hill (see paragraph 3.26) had been at a multiple of 8.5 times the net cash flows, and 10 times forecast operating profit. It calculated that the application of these multiples indicated a purchase price for Coral between some £350 million and £410 million. Ladbroke said that the consideration was within this range, which showed that it had not paid a premium price for the augmentation of its betting shop presence in the UK. Ladbroke also said that it had accepted Bass's requirement that offers for Coral should be unconditional, because of its belief that 'non-trade' bidders would have accepted this condition [

Details omitted. See note on page iv.]

It paid the cash consideration for the purchase on 2 January 1998.

3.35. By an agreement dated 31 December 1997 (the day the merger agreement was made) Ladbroke agreed conditionally to sell 134 betting shops to Tote Bookmakers (see also paragraph 6.2). The agreement was varied by subsequent agreements between the parties. [

Details omitted. See note on page iv.

]

3.36. Ladbroke considered the agreement to be specifically enforceable provided that Tote Bookmakers was not prevented, by the outcome of this MMC reference, from retaining more than 69 of the LBOs covered by the agreement. Ladbroke told us that its position was supported by advice received from leading counsel. The agreement is enforceable in respect of any individual LBO only if certain conditions are satisfied in respect of it. One of the conditions is that the property must be freehold or, if it is leasehold, any necessary landlord's consent is obtained or a court has declared his

[§<]

consent as unreasonably withheld or a new lease is granted. The latest information we received from Ladbroke was that out of the 134 properties, 17 were freehold, and of the 117 leasehold properties, 92 licences to assign had been completed. Terms had been agreed and engrossments prepared for an additional 20 (the engrossments being with either Tote Bookmakers or landlords for signature) and five licences to assign were still being negotiated. Another point of note is that under the agreement as it stands, if the question of whether Tote Bookmakers can retain more than 69 properties is not resolved by 31 December 1998, it appears that Ladbroke would not have to complete the sale of any of the LBOs.

3.37. Ladbroke said that its inability to commence the integration process arising from the reference to the MMC had delayed its first year's profit improvement plans for Coral, but that trading in the year to date had met its overall expectations. Ladbroke also told us that measures to tighten security had already improved Coral's gross margins.

Other leading bookmaking firms

William Hill Organization Limited

3.38. William Hill was owned by Brent Walker until October 1997 when it was acquired by Nomura, which is its indirect beneficial owner. William Hill's activity is the operation of betting shops and betting services and a telephone betting business. Table 3.11 shows the summary of William Hill's performance for the five years to 1997. Its shop numbers declined from an average of 1,639 in 1993 to 1,520 in 1997. Over the five years its total turnover increased from £1.53 billion to £1.67 billion with a dip in 1995 as a result of the introduction of the National Lottery. Its annual gross profit was in the range of £[§] million to £[§] million in the four years to 1996, and increased to £[§] million in 1997. The operating profit was £47 million for 1993, increased to £57 million in 1994, fell back to £39 million in 1995 and thereafter increased to £76 million by 1997. Over the five years the average betting turnover per shop increased from £843,000 in 1993 to £910,000 in 1997. The operating profit as a percentage of turnover was 4.6 per cent in 1997, compared with a low point of 2.5 per cent in 1995.

TABLE 3.11 William Hill: performance by activity, 1993 to 1997

	Years ended December*				
	1993	1994	1995	1996	1997
Average number of shops	1,639	1,613	1,580	1,546	1,520
	<i>£ million</i>				
<i>Turnover</i>					
Betting shops	1,382	1,394	1,344	1,399	1,383
Telephone betting	136	171	186	199	220
Index†	-	-	1	18	25
Course‡	<u>16</u>	<u>18</u>	<u>20</u>	<u>21</u>	<u>23</u>
	1,534	1,583	1,551	1,637	1,651
AWP and other	<u>-</u>	<u>-</u>	<u>-</u>	<u>10</u>	<u>22</u>
	1,534	1,583	1,551	1,647	1,673
<i>Gross margins§</i>	<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 10px;">{</div> <div style="text-align: center;"> <p><i>Figures omitted.</i> See note on page iv.</p> </div> <div style="font-size: 4em; margin-left: 10px;">}</div> </div>				
Betting shops					
Telephone betting					
Index					
Course					
AWP and other					
<i>Gross profits</i>	<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 10px;">{</div> <div style="text-align: center;"> <p><i>Figures omitted.</i> See note on page iv.</p> </div> <div style="font-size: 4em; margin-left: 10px;">}</div> </div>				
Betting shops					
Telephone betting					
Index					
Course					
AWP and other					
Operating profit	47	57	39	49	76
	<i>£'000</i>				
Betting turnover per shop	843	864	851	905	910
	<i>per cent</i>				
<i>Performance percentages</i>	<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 10px;">{</div> <div style="text-align: center;"> <p><i>Figures omitted.</i> See note on page iv.</p> </div> <div style="font-size: 4em; margin-left: 10px;">}</div> </div>				
Gross margin as percentage of turnover for betting shops					
Gross profit as percentage of turnover for betting shops					
Gross margin as percentage of turnover for telephone betting					
Gross profit as percentage of turnover for telephone betting					
Operating profit as percentage of turnover					

Source: William Hill.

*All years are for 52 weeks ending in December except for 1996 which is for 53 weeks ending in December.

†Index is otherwise known as spread betting.

‡This relates to on-course betting placed with William Hill at the rails at horse-race courses.

§Gross margin is turnover after return of stakes and customer winnings.

3.39. Table 3.12 analyses William Hill's performance by activity for 1997. The gross margin percentage from betting shops was almost [3.0] per cent compared with [4.6] per cent for telephone betting. Duty and levies as a percentage of turnover amounted to [2.5] per cent for the betting shops.

TABLE 3.12 William Hill: analysis of 1997 activities

		£ million			per cent		
	Turnover	Gross margin*	Duties levies and VAT	Profit after costs	Gross margin	Duties and levies difference	Gross profit after duty and levies
Betting shops†	1,383	() Figures omitted. See note on page iv.	() Figures omitted. See note on page iv.	() Figures omitted. See note on page iv.	() Figures omitted. See note on page iv.	() Figures omitted. See note on page iv.	() Figures omitted. See note on page iv.
Telephone betting	220						
Index	25						
Course	23						
Total excluding AWP	1,651						
AWP and other‡	22						
	1,673				N/A	N/A	N/A
Operating costs							
Operating profit				76			

Source: William Hill.

*The gross margin is calculated after deducting returns on stakes and customer winnings, but before deducting duties, levy payments and VAT on AWP.

†The average number of shops in 1997 was 1,520 compared with 1,546 in 1996. William Hill analysed the turnover into: horse-race betting £978 million (71 per cent), greyhound racing £275 million (20 per cent), numbers betting £52 million (3.8 per cent) and other betting £78 million (5.6 per cent).

‡AWP income is that from gaming machines in shops. The gross margin shown is before deductions for machine rentals, gaming machine duties and VAT.

3.40. Table 3.13 shows William Hill's balance sheet as at 30 December 1997 (ie following its acquisition from Brent Walker). William Hill told us that it did not believe that balance sheet information for earlier years provided a useful comparator due to the ownership structure and complexities of the Brent Walker group to which it had belonged.

TABLE 3.13 William Hill: balance sheet at 30 December 1997*

	£m
Tangible assets†	() ≪
Working capital	
Net operating assets	
Investments‡	
Borrowings (including amounts falling due after one year)	
Reported net operating liabilities)
	%
Operating profit as percentage of closing net operating assets§	[≪]

Source: William Hill.

*For the Grand Bookmaking Company Limited, which is the non-trading parent company of William Hill and was formed in 1997 to acquire William Hill from Brent Walker.

†Valuation of betting shops as determined by chartered surveyors at 1 September 1997. The aggregate value of LBOs, determined by valuation on an existing use basis as fully operating business units, and of the principal administrative properties on an existing use basis was £[≪] million, to which were added fixtures, vehicles and equipment not included in the valuation with a net book value of £[≪] million.

‡The book value of William Hill's investment in SIS which at the balance sheet date was 14.8 per cent. On 14 March 1998 William Hill increased the holding by 4.2 per cent for a consideration of £[≪] million, which implies a valuation for SIS of £[≪] million and a value of William Hill's holding of £[≪] million.

§Takes account of the operating profit for the year 1997 of £76 million. However, William Hill was under the ownership of two entities during the year, and this calculation is based on the closing valuation of the Grand Bookmaking Company Limited's net operating assets.

Horserace Totalisator Board

3.41. The Tote is a statutory body corporate, the members of which are appointed by the Home Secretary. It was originally established by the Racecourse Betting Act 1928 and it is now constituted under the Betting, Gaming and Lotteries Act 1963. The 1963 Act gives it the exclusive right to carry

on a pool betting business on horse racing and to authorize others to carry on the business of accepting bets at Tote odds where the stake does not go into the Tote pool. It is run as a commercial operation and its profits, other than those necessary to be retained for investment and growth, are used to support horse racing. In 1972 the Tote was given the power to accept fixed odds bets but only on sporting and other events approved by the Home Secretary. In 1996/97 its power to accept fixed odds betting was extended to all events other than the National Lottery: until then it had been unable to offer numbers betting products.

3.42. The Tote has four areas of business activity:

- (a) on-course betting: pool betting activities conducted at horse racecourses as a division of the Tote;
- (b) Tote Direct: a business launched in 1992 as a 50:50 joint venture with Bass which enables stakes taken in LBOs to be routed into the Tote's on-course pools: Ladbroke took a one-third share in the company in 1997 and following the merger with Coral has agreed to be the joint owner, 50:50, with the Tote (see Appendix 3.1, paragraph 10);
- (c) Tote Bookmakers: a wholly-owned subsidiary operating a chain of LBOs numbering some 200 at 31 December 1997 (excluding the LBOs conditionally acquired from Ladbroke on that date), together with around 70 on-course betting shops at 40 racecourses; and
- (d) Tote Credit: a wholly-owned subsidiary operating a telephone betting business.

In addition the Tote receives authority fees from off-course bookmakers for the right to conduct betting at Tote odds where the stakes do not become part of the Tote's pools.

3.43. Table 3.14 shows the summary profit and loss account of the Tote for the five years to the end of March 1998. Total turnover increased by 65 per cent from £240 million in 1993/94 to £397 million in 1997/98. The Tote told us that its turnover growth in 1996/97 (5 per cent) was depressed because the Tote was precluded by statute from fully participating in numbers betting until February 1997. Over the five years, the Tote's operating profit (which, unlike the other bookmakers, it shows before deducting betting levy) increased from £7.9 million in 1993/94 to £16.3 million in 1997/98. Restating the profit to adjust for the betting levy, the increase over the five years was from £6.5 million in 1993/94 to £14.1 million in 1997/98. The Tote's annual contributions to racing over the period increased from £6.3 million to £9.3 million. Its restated operating profit as a percentage of turnover fluctuated between 2.7 and 3.6 per cent over the five years.

3.44. The Tote told us that in the year to March 1998 its performance had again improved over the levels of earlier years and its average turnover per shop had recovered to some £680,000. This compares with the expected turnover per shop of some £[] from the 134 additional shops it conditionally acquired from Ladbroke on 31 December 1997. It told us that the opportunity to acquire such a block of shops was a crucial contribution to its strategy of developing its bookmaking chain. It said that its lower average shop turnover was primarily due to the location of its shops, which in many cases occupy poorer trading positions than those of its largest competitors. This was a result of the Tote being prevented by law from operating LBOs offering fixed odds betting when it was first lawful to do so in 1961. Only in 1972 was the law changed to allow the Tote to operate LBOs on an equivalent basis to other bookmakers, by which time most of the best trading sites in the country had been taken. The Tote's accounts for the year to 31 March 1998 include the results of the shops acquired from Ladbroke for the period from 2 February 1998 (to which the Tote is unconditionally entitled), and show the cost of the acquisition as betting office assets in the course of acquisition. The income it earns from these shops is in lieu of interest on its cash outlay.

TABLE 3.14 The Tote: consolidated profit and loss account summary, 1993/94 to 1997/98

	Years ended 31 March				
	1994	1995	1996	1997	1998
Average number of shops*	163	162	207	216	232
	<i>£ million</i>				
On-course betting	65.7	71.5	72.6	75.8	84.0
Tote Direct	<u>9.0</u>	<u>26.7</u>	<u>29.1</u>	<u>33.2</u>	<u>48.9</u>
Pool betting total	74.7	98.2	101.7	109.0	132.9
Tote Credit	45.4	51.1	56.4	67.6	88.0
Tote Bookmakers	<u>120.3</u>	<u>122.7</u>	<u>146.1</u>	<u>143.4</u>	<u>176.1</u>
Turnover	240.4	272.0	304.2	320.0	397.0
Paid to winning customers	(189.2)	(211.7)	(238.3)	(251.7)	(310.2)
Betting duty	(11.1)	(11.7)	(13.7)	(12.5)	(15.9)
Tote Direct commissions	<u>(1.7)</u>	<u>(6.0)</u>	<u>(6.5)</u>	<u>(7.0)</u>	<u>(10.8)</u>
Gross profit	38.4	42.6	45.7	48.8	60.1
Operating expenses	<u>(30.5)</u>	<u>(32.3)</u>	<u>(35.4)</u>	<u>(36.8)</u>	<u>(43.8)</u>
Operating profit†	7.9	10.3	10.3	12.0	16.3
Income from SIS investment	3.3	0.0	0.3	0.4	0.4
Levy and racing industry contributions	<u>(6.3)</u>	<u>(6.7)</u>	<u>(7.6)</u>	<u>(7.9)</u>	<u>(9.3)‡</u>
Profit before taxation	4.9	3.6	3.0	4.5	7.4
Operating profit as restated§	6.5	8.8	8.7	10.3	14.1
	<i>per cent</i>				
<i>Performance indicators summary</i>					
Turnover growth	7	13	12	5	24
Gross profit as percentage of turnover	16	16	15	15	15
Restated operating profit as percentage of turnover	2.7	3.2	2.9	3.2	3.6
Turnover per shop (£'000)¶	668	686	670	642	680

Source: The Tote.

*In addition to its off-course shops, Tote Bookmakers operates 67 on-course betting shops at 39 racecourses. On 31 December 1997 the Tote conditionally acquired an additional 134 off-course shops from Ladbroke.

†The operating profit as disclosed in the published accounts is different because the figures shown here are net of other items such as net interest payable, which for 1996 and 1997 was some £400,000.

‡ For 1997/98 this comprises betting levy of £2.2 million, discretionary payments to horse racing of £5.8 million, sponsorship of £1.2 million and voluntary payments to greyhound racing of £0.1 million.

§After deducting betting levy which is shown by other bookmakers as a deduction in arriving at gross profit. The adjustment excludes sponsorship payments because the Tote regards these payments as material voluntary contributions to racing.

¶The average turnover per shop is not directly based on Tote Bookmakers' published turnover because that figure includes turnover from racecourse betting shops. The average for 1997/98 was some £680,000 excluding the shops acquired from Ladbroke on 31 December 1997, which have an average turnover of some £[] a year.

3.45. Table 3.15 summarizes the Tote's balance sheets for the five years to 31 March 1998. Net operating assets increased from £37 million in March 1994 to £44 million in March 1997, and then to £99 million at March 1998 with the conditional acquisition of the Ladbroke shops. Restated operating profits as a percentage of average net operating assets were in the range of 22 to 25 per cent in the last four years of the period.

TABLE 3.15 The Tote: consolidated balance sheets, 1994 to 1998

	As at 31 March					£ million
	1994	1995	1996	1997	1998	
Tangible fixed assets	20.8	21.1	21.0	20.7	20.7	
Intangible assets and investments	22.3	22.3	30.0	32.2	48.1*	
LBOs in the course of acquisition	-	-	-	-	46.6	
Working capital (excluding bank balances)	(6.1)	(7.6)	(7.4)	(8.7)	(16.7)	
Net operating assets	37.0	35.8	43.6	44.2	98.7	
Net cash balances/(borrowings)	1.1	2.3	1.1	2.2	(37.4)†	
Long term liabilities	(3.6)	(1.4)	(6.0)	(4.6)	(0.7)	
Net assets	34.5	36.7	38.7	41.8	60.6	
						per cent
Restated operating profit as percentage of average net operating assets	18	24	22	23	25	

Source: The Tote.

*Betting shop licences are valued at £43 million. The balance represents the Tote's valuation of its investment in SIS at £4.6 million (compared with historical cost of £1.7 million) and £0.6 million being its estimate of the value of its 50 per cent investment in Tote Direct.

†The Tote obtained a bridging loan of some £45 million repayable by 31 January 1999 to effect the conditional purchase of the Ladbroke shops. The Tote told us that the loan would be refinanced after completion of the agreement.

3.46. At March 1997 the Tote valued its betting office businesses, including the licences, at £27 million, compared with historical cost of £18.5 million. The Tote told us, however, that its valuation in 1997 was conservative and at March 1998 it had revised its valuation to £43 million (of which £1.6 million represented additions in 1997/98). In addition, it would add the cost of the shops acquired from Ladbroke (£47 million) to the value of its estate once the transaction was completed.

3.47. Table 3.16 shows the Tote's performance for 1997/98 analysed into Tote pool betting and fixed odds betting activities. On-course betting achieved a gross profit of [§<] per cent of turnover and an operating profit of [§<] per cent. By comparison, Tote Direct shows a gross profit of [§<] per cent after payments of commissions to other bookmakers. Tote Bookmakers had turnover of £176 million and showed a gross profit of [§<] per cent and an operating profit of [§<] per cent. Tote Credit generated a similar level of operating profit (£[§<] million) to Tote Bookmakers on turnover of £88 million, compared with £176 million for Tote Bookmakers.

TABLE 3.16 The Tote: analysis of trading activities for 1997/98

	Tote pool betting		Fixed odds betting		£ million	
	On-course betting	Tote Direct	Tote Bookmakers	Tote Credit	Head office	Total
Turnover	84	49	176	88	-	397
Winnings to customers						(310)
Betting duty						(16)
Tote Direct commissions						(11)
Gross profit						60
Operating expenses					[§<]	(44)
Operating profit						16
Levy and racing industry contributions						(9)
Other income net of other charges						0
Profit before taxation					*	7
						per cent
<i>Performance indicators</i>						
Gross margin as percentage of turnover†						21
Gross profit as percentage of turnover					[§<]	15
Operating profit as percentage of turnover						4
Net profit as percentage of turnover						2

Source: The Tote.

*Other income was £[§<] million and is offset by other charges of the same amount.

†Gross margin is turnover net of customer winnings.

Stanley Leisure plc

3.48. Stanley is a public company listed on the London Stock Exchange. At 20 July 1998 its market capitalization was £360 million and its price:earnings ratio was almost 20. The group operates a chain of some 570 betting shops, of which some 475 are in Great Britain, predominantly in the north-west of England. It also has other activities, including the ownership and management of casinos. It had average full-time employee numbers of some 4,500 in 1997, of which the racing division had 2,500.

3.49. Table 3.17 shows Stanley's summarized profit and loss account for the four years to the end of April 1997. Its turnover from racing activities increased by 57 per cent over three years from £232 million in 1993/94 to £364 million by 1996/97, the majority of the increase being in 1996/97 when acquisitions contributed £50 million to racing turnover. Over this period, the turnover from other activities increased by 30 per cent from £33 million to £43 million. Operating profits were £15 million in 1993/94 and increased by 43 per cent to £22 million by 1996/97, representing a fall in operating profit as a percentage of turnover from some 6 per cent in 1994/95 to 5 per cent in 1996/97. Its turnover per shop is in the region of £670,000.

TABLE 3.17 **Stanley: consolidated profit and loss account summary, 1994 to 1997**

	<i>Years ended 30 April</i>			
	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>
Average number of shops	409	425	445	535
	<i>£ million</i>			
Racing*	232.2	257.6	277.2	363.6
Other activities*	<u>32.9</u>	<u>35.5</u>	<u>40.9</u>	<u>43.2</u>
Turnover	<u>265.1</u>	<u>293.1</u>	<u>318.1</u>	<u>406.8</u>
Gross profit†	16.8	20.0	17.6	24.2
Operating profit†	15.4	18.7	16.2	22.0
Profit before taxation	12.4	17.0	14.8	19.4
	<i>per cent</i>			
<i>Performance indicators summary</i>				
Turnover growth	21	11	9	28
Gross profit as percentage of turnover	6	7	6	6
Operating profit as percentage of turnover	6	6	5	5
Profit before taxation as percentage of turnover	5	6	5	5
Turnover per shop (£'000)	571	607	621	672

Source: Stanley.

*Racing turnover is before return of stakes and winnings to customer. Most of the other activities turnover relates to casino activities and is shown as the gross gaming win, which is after customer winnings.

†The gross profit is turnover net of cost of sales. The operating profit is the gross profit less administration expenses.

3.50. Table 3.18 shows Stanley's summary balance sheets for the four years to 30 April 1997. Stanley revalues its premises to take account of their existing use as LBOs and casinos and at April 1997 they had a value of £180 million. The last valuation exercise was in May 1993. Stanley does not show the licences as an intangible asset in its accounts. Net operating assets increased over the three years to 1996/97 from £136 million to £186 million. The operating profit as a percentage of average net operating assets fluctuated between 11 and 14 per cent over the period.

TABLE 3.18 Stanley: consolidated balance sheets, 1994 to 1997

	£ million			
	As at 30 April			
	1994	1995	1996	1997
Tangible fixed assets*	147.4	150.9	172.8	203.9
Working capital (excluding bank balances)	(11.1)	(13.9)	(12.9)	(18.3)
Net operating assets	136.3	137.0	159.9	185.6
Borrowings net of cash	2.6	2.8	3.6	(1.6)
Long-term creditors and provisions	(15.8)	(8.3)	(25.2)	(32.1)
Net assets	123.1	131.5	138.3	151.9
	<i>per cent</i>			
Operating profit as percentage of average net operating assets	12	14	11	13

Source: Stanley.

*This includes the value of betting shops. Stanley had its properties revalued by chartered surveyors at 2 May 1993 on an open market value and fully operational basis for their existing use, including the benefit of casino and betting office licences. At 1997, £180 million represented the value of properties, and the balance represented other tangible fixed assets.

Comparisons of performance

3.51. Table 3.19 shows a detailed analysis of Ladbroke's and Coral's turnover by betting category for 1996, 1997 and the first four months of 1998, whilst Tables 3.11 and 3.12 show equivalent information for William Hill.

TABLE 3.19 Comparison of Ladbroke and Coral turnover by separate betting activities

	£ million					
	Ladbroke 1996	Coral 1995/96	Ladbroke 1997	Coral 1996/97	Ladbroke 4 months to April 1998	Coral
<i>Turnover*</i>						
Horses	1,096	520	1,129	551	Figures omitted. See note on page iv.	
Greyhounds	334	151	322	160		
Numbers	24	25	63	27		
Football	66	19	64	20		
Other sports, etc	12	7	12	7		
AWP takings after payout	12	3	28	13		
Subtotal	1,544†	725	1,618†	777		
Belgium and Republic of Ireland	221	-	186	-		
Turnover per accounts	1,765	725‡	1,804	777‡		
	<i>per cent</i>					
<i>Percentage analysis by activity</i>						
Horses	71.0	71.8	69.8	70.9	67.4	70.8
Greyhounds	21.6	20.8	19.9	20.6	20.4	20.6
Other betting activities (see below)	7.4	7.4	10.3	8.5	12.2	8.6
Total for reference activities	100.0	100.0	100.0	100.0	100.0	100.0
<i>Other betting activities</i>						
Numbers	1.5	3.5	3.9	3.5	4.1	3.5
Football	4.3	2.6	4.0	2.5	5.6	2.6
Other sports etc	0.8	0.9	0.8	0.9	0.7	0.8
AWP takings after payout	0.8	0.4	1.6	1.6	1.8	1.7

Source: Ladbroke.

*The Ladbroke figures are for the year to 31 December whereas the Coral figures are for the year to 30 September.

†The totals include on-course shop turnover, which was £[£] million in 1996 and £[£] million in 1997 for Ladbroke.

‡These figures are different from Table 3.9 because they exclude Tote Direct turnover but include AWP takings.

3.52. Ladbroke's UK betting shop turnover for 1997 of £1.62 billion compares with £777 million for Coral shops in the year to end-September 1997. In the four-month period to April 1998, Ladbroke's shop turnover was £[£] million compared with £[£] million for the Coral shops. The percentages of turnover on horse racing and greyhound racing, at around 70 and 20 per cent respectively, are similar for both companies. (We do not place weight on the breakdown for the first four months of 1998 because it is likely to be influenced by seasonal factors. In particular, there seems to be room for doubt in the numbers business. We were told by Ladbroke that this had peaked but in

our view it is too soon to draw conclusions as to the likely future trend.) Numbers betting in Ladbroke's shops increased from 1.5 per cent of turnover in 1996 to some 4 per cent in 1997, but in Coral's shops remained at 3.5 per cent for both years.

3.53. Ladbroke told us that Coral was unable to analyse its gross margin by detailed betting category but that Ladbroke's own systems for bet capture could provide this information. Ladbroke had a horse-betting margin in the range of [] to [] per cent in the period from 1 January 1996 to 30 April 1998. For greyhound racing, its margin was [] per cent in 1996 which [] per cent in the four months to April 1998. Numbers and football betting have had margins in excess of those for horse racing and greyhound racing and which have fluctuated in the ranges of [] to [] per cent for numbers betting and [] to [] per cent for football betting—see paragraphs 4.89 to 4.93 which explain the reason for differences in margins. The overall average gross margin of Ladbroke over the eight years to 1996/97 of [] compares with [] per cent for Coral. In respect of recent periods, the average overall Ladbroke margin from all betting activities for 1996 of [] per cent compares with [] per cent for Coral; for 1997 Ladbroke's margin of [] per cent compares with [] per cent for Coral; and for the four months to April 1998 the Ladbroke margin of [] per cent compares with [] per cent for Coral. William Hill's overall margin has ranged between [] and [] per cent over the five years to 1997 (see Table 3.11).

3.54. Table 3.20 compares shop numbers, turnover per shop and gross margin percentages for Ladbroke, Coral and William Hill in 1996 and 1997, together with the forecasts for Ladbroke and Coral in 1998. In 1997 both Coral and William Hill had a turnover per shop of £910,000 whilst Ladbroke's figure was £838,000. [] *Details omitted. See note on page iv.*

[] Those represent average percentages of [], [] and [] on turnover. Thus, [] Ladbroke has the [] turnover per

TABLE 3.20 Comparison of shop numbers, turnover and gross margin per shop for major bookmakers*

	1996*	1997*	Forecast 1998 before sale to the Tote	Forecast 1998 assuming sale to the Tote†
<i>Average shop numbers</i>				
Ladbroke	1,819	1,896	1,909	1,857
Coral	<u>862</u>	<u>840</u>	<u>829</u>	<u>747</u>
Combined	2,681	2,736	2,738	2,604
William Hill	[]	[]	‡	‡
£'000				
<i>Turnover per shop§</i>				
Ladbroke	842	838	860	865
Coral	<u>838</u>	<u>910</u>	<u>957</u>	<u>975</u>
Combined	841	860	890	899
William Hill	905	910	‡	‡
<i>Gross margin per shop¶</i>				
Ladbroke	[]	[]	[]	[]
Coral	[]	[]	[]	[]
Combined	[]	[]	[]	[]
William Hill	[]	[]	‡	‡
per cent				
<i>Gross margin</i>				
Ladbroke	[]	[]	[]	[]
Coral	[]	[]	[]	[]
William Hill	[]	[]	‡	‡

Source: MMC based on information from companies.

*Ladbroke and William Hill data are for calendar years as are Coral data for 1998. Coral data for 1996 and 1997 are for years ended 30 September.

†Ladbroke told us that its forecast was prepared assuming the sale to the Tote. It had not prepared a forecast on the 'before sale to the Tote' basis but the shops conditionally sold to the Tote had turnover and gross margins that were on average not significantly different from those that were retained.

‡Not available.

§Ladbroke estimated that the average turnover of independent betting shops was in the region of £500,000. Table 3.14 shows that Tote Bookmakers' average turnover per shop was some £680,000 and for Stanley Table 3.17 shows the average turnover per shop was in the region of £670,000.

¶Betting turnover net of customer winnings.

⊞The MMC have advised that these figures are inaccurate and they have been excised in accordance with section 83(3) of the Fair Trading Act 1973. They should correctly have read '1,546' and '1,520'.

shop, its percentage gross margin is the [≪] of the three. The BBOA, a trade association representing mainly independent off-course bookmakers, estimated that 22 per cent was a typical gross margin for independent bookmakers as at February 1998.

3.55. Table 3.21 compares the telephone betting activities for Ladbroke, Coral, William Hill and the Tote. The margins from telephone betting are less than those for the horse-racing and greyhound-racing activities. Ladbroke told us this was partly a reflection of the much higher proportion of single bets taken by telephone, compared with via LBOs, which were less profitable than other types of bets. William Hill is easily the leader with turnover of £220 million for 1997, which compares with combined turnover for Ladbroke and Coral of £192 million.

TABLE 3.21 Comparison of turnover and gross margin for UK telephone betting activities

£'000		
	1996	1997
<i>Turnover</i>		
Ladbroke	107	137
Coral	47	55
William Hill	199	220
Tote Credit	56	68
Others	*	<u>48</u>
	*	<u>528</u>
<i>per cent</i>		
<i>Gross margins†</i>		
Ladbroke	[≪]	
Coral	[≪]	
William Hill	[≪]	
Tote Credit	[≪]	

Source: MMC based on information from Ladbroke, William Hill and the Tote.

*No information.

†Betting turnover net of customer winnings.

3.56. The BBOA provided us with its analysis for independent betting shops at dates in 1995 and 1998 designed to show their relative profitabilities at different levels of turnover. Table 3.22 suggests that the breakeven point for an independent bookmaker's betting shop may have been in the range of £364,000 to £416,000 at June 1995 and in the range of £260,000 to £364,000 at February 1998. The BBOA's data suggest that, even at a turnover level of £520,000 in 1995, the likely level of profits was £8,000. The BBOA estimated that the introduction of AWP's at betting shops was likely to produce income of between £3,000 and £6,000 a shop. This had improved the profitability of shops and lowered the breakeven point. The data suggest that at a turnover level of £468,000 in 1998, independent bookmakers might make a profit of £12,000, which would increase to £23,000 at a turnover level of £572,000. This compares with Ladbroke's own estimates for a typical independent bookmaker having a turnover of £550,000 where it estimated a shop contribution of some £22,000 (see also paragraph 3.10). The BBOA, however, told us that there had been a downward trend in turnover of independent betting shops since 1993; therefore it was not certain that a shop would have maintained the same level of turnover in 1998 that it had achieved in 1995.

TABLE 3.22 Profitability ranges for independent bookmakers at 1995 and 1998

	£'000					
<i>As at June 1995</i>						
Annual turnover level	260	312	364	416	468	520
Gross margin (21.5%)	56	67	78	89	101	112
Profit/(loss) after managers' wages and hedging	(7)	0	(4)*	2	1	8
<i>As at February 1998</i>						
Annual turnover level	260	364	468	572	676	780
Gross margin (22%) plus AWP takings	60	83	107	131	154	178
Profit/(loss) after managers' wages and hedging	(4)	5	12	23	31	42

Source: BBOA.

*The reduction in profitability is due to estimated increases in costs that are not offset by increases in margin.

3.57. Ladbroke told us that the contribution level from a shop was very much dependent on factors such as actual betting margin percentages, shop rental costs and performance of AWP's, and that the variability of these factors was large. Therefore contribution was very variable and a breakeven turnover point was difficult to determine. Ladbroke asserted that shops operating at turnover levels below £500,000 might well return a high contribution and it would be misleading to classify all shops operating below £500,000 as being below a breakeven point. It therefore put it to us that turnover should not be seen as necessarily the main driver of shop profitability.

Distribution of the punter's pound

3.58. All off-course bookmakers make deductions from punters' bets at a common rate, presently 9 per cent (see paragraphs 4.26 to 4.29). Punters are usually given the option to decide whether 9 per cent should be added to the stake or deducted from the winnings. The deduction is imposed by bookmakers to enable them to recover their liabilities for betting duty and levies but the rate of deduction itself has no precise link to rates of betting duty and levies. Table 3.7 shows the information for Ladbroke in respect of deductions, betting duty and levies for the year to March 1998. Levies apply only to betting on horse and greyhound racing. The betting duty, however, applies to all forms of betting and is currently 6.75 per cent. Bookmakers with betting offices on horse-race courses normally make a deduction of 6 per cent to cover part of their payments to the racecourses, but this on-course deduction is not related to the 9 per cent off-course deduction.

3.59. We asked Ladbroke to provide us with an estimate of how a £1 bet would be distributed between winnings, duty and levy deductions, operating costs and profits. Table 3.23 shows Ladbroke's estimate for the betting industry in 1996 and the particular allocations relating to itself and Coral. The gross margin for Ladbroke is [36] per cent, compared with [36] per cent for Coral (albeit for a slightly different period) and [36] per cent for the rest of the industry (derived on the basis set out in the footnotes to the table). The betting duty and levies represent, respectively, the contribution to the exchequer (in addition to general taxation) and to the racing industry from the betting industry.

Satellite Information Services

3.60. Satellite Information Services (Holdings) Limited is the non-trading holding company for Satellite Information Services Limited. It was established in 1986 on the initiative of the then four major bookmakers in order to transmit to LBOs live television pictures and commentaries covering each day's racing. At that time the Tote acquired a 5 per cent shareholding and the RCA negotiated a 10 per cent shareholding as part of the consideration for granting SIS rights of access to the racecourses (see also paragraphs 4.94 to 4.99).

3.61. In the period up to 1989 the shareholders injected loans (carrying a market rate of interest) of £45 million into SIS, of which Ladbroke's contribution was almost £14 million. In 1990, at the behest of the RCA, there was a private placing to reduce the combined interest of the bookmakers (excluding the Tote) from 85 to 45 per cent. This attracted two commercial investors, Racal and MAI (which subsequently became part of United News & Media), which acquired shareholdings valuing the company (at the placing price) at over £100 million. The loans were repaid to the original shareholders who simultaneously subscribed for £8.5 million of loan stock, of which Ladbroke's share was £2.5 million. This was subsequently repaid in the financial year to 31 March 1992. Table 3.24 shows SIS's shareholders at December 1997 (prior to the Coral acquisition), and immediately following the exercise of pre-emption rights under the Articles which were triggered by Ladbroke's acquisition of the Coral betting business from Bass. The bookmakers' combined shareholding (excluding the Tote) was reduced from 44.4 to 41.8 per cent.

TABLE 3.23 Analysis of the punters' pound for 1996

	Industry*			Ladbroke†			Coral‡			Other‡		
	£m	%	%	£m	%	%	£m	%	%	£m	%	%
Betting turnover§	6,596		100.0	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)	(Figures omitted. See note on page iv.)
Returns to customers	<u>-5,130</u>		<u>-77.8</u>									
Actual customer spend (gross margin)§	1,466	100.0	22.2									
Duty¶	-454	-31.0	-6.9									
Horse-race levy (reflects sales mix)	-49	-3.3	-0.7									
Greyhound fund	-3	-0.2	0.0									
Operating costs	<u>-795</u>	-54.2	<u>-12.1</u>									
Net profit	165	11.3	2.5									
<i>per cent</i>												
<i>Percentages by category</i>												
Betting turnover	100			(✂)			(✂)			(✂)		
Net profit	100											

Source: Ladbroke.

*Industry figures are from Salford University/Industry Forum.

†Ladbroke and Coral figures are from management accounts for betting shops. Ladbroke is for the year to December 1996, Coral for year to September 1996. Coral's results look particularly unfavourable because its year-end profit reflected the payouts for the unprecedented Dettori results on 28 September 1996 (ie very close to Coral's year end) and did not show the benefit from the winnings being recycled into betting in early October.

‡This column is notional because the accounting periods differ for the Ladbroke and Coral information. It is a cross-check to form a view on the relationship of Ladbroke/Coral to the industry totals. Ladbroke told us that the industry profit of £[] million for 1996 was not meaningful because of the accounting period differences.

§The betting turnover is equivalent to 'drop', a term commonly used in gaming businesses. The estimate shows industry total spend at £6.596 billion of which the actual customer spend is estimated to be £1.466 billion (22.2 per cent) and represents the amount left with bookmakers as their 'take' from the betting activities. The totals exclude on-course betting.

¶In March 1996 the rate of betting duty was cut from 7.75 to 6.75 per cent. Coral's 1996 results therefore include five months at the earlier higher rate of duty whilst Ladbroke figures incorporate only two months at the higher rate.

TABLE 3.24 Shareholdings in SIS*

	<i>Pre-Coral acquisition</i>	<i>Changes as a result of Coral acquisition</i>	<i>per cent Post-Coral acquisition</i>
Ladbroke	17.8	+5.0	22.8
William Hill	14.8	+ 4.2†	19.0
Bass	<u>11.8</u>	<u>-11.8</u>	<u>0.0</u>
Bookmakers' total	44.4	-2.6	41.8
Racal	22.0	-	22.0
United (formerly MAI)	17.5	+2.5†	20.0
RCA	9.9	+0.1†	10.0
Tote	5.8	-	5.8
Employee shareholding	<u>0.4</u>	<u>-</u>	<u>0.4</u>
	100.0	0	100.0

Source: SIS.

*Figures rounded to one decimal place.

†Shareholding increases as a result of the exercise of pre-emption rights.

3.62. The consolidated profit and loss account of SIS for the year ended 31 March 1997 shows its turnover at £79 million (1996, £78 million) and profit before tax of £23.5 million (1996, £20.7 million). It paid dividends of £8 million in 1997 (1996, £7 million). Table 3.25 shows a summary of SIS's consolidated balance sheets as at 31 March 1996 and 1997. It had a net asset deficiency of £6 million at 31 March 1997. Ladbroke, however, told us that the shareholders considered that SIS had a market value of some £143 million in 1998.

TABLE 3.25 SIS: consolidated balance sheets, 1996 and 1997

	<i>£ million</i>	
	<i>As at 31 March</i>	
	1996	1997
Tangible fixed assets	16	16
Stocks and debtors	7	8
Creditors	(24)	(27)
Bank borrowings	(13)	(3)
Net deficiency of assets*	(14)	(6)

Source: SIS.

*This is equal to shareholders' funds, of which called-up share capital is some £22,000.

3.63. Table 3.26 shows the analysis of SIS's UK turnover from its betting services for 1997/98 between its major customers. Ladbroke, William Hill and Coral together accounted for [§] per cent of SIS's income from bookmaker customers.

TABLE 3.26 SIS: turnover analysis for 1997/98

	<i>Racing broadcasts*</i>	<i>Text systems*</i>	<i>Other</i>	<i>£ million Total</i>	<i>%</i>
Ladbroke	<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 10px;">{</div> <div style="text-align: center;"> <i>Figures omitted.</i> <i>See note on page iv.</i> </div> </div>				<div style="display: flex; align-items: center; justify-content: center;"> <div style="font-size: 4em; margin-right: 10px;">{</div> <div style="text-align: center;"> § </div> </div>
William Hill					
Coral					
Tote					
Other					

Source: SIS

*Income charges on a per site basis

3.64. SIS told us that its management was independent of any of its shareholders, although the officers communicated regularly with the bookmaker shareholders at all levels. SIS told us that this communication was essential so that it could respond to customer demand: the major bookmakers provided an important channel of feedback and suggestions. SIS told us that it treated shareholder-related customers in the same manner as it treated unrelated customers. The board made decisions in the

interests of the company rather than of the individual shareholders, and the Articles precluded directors from voting on a matter in which they had a material interest which might conflict with the company's interest (see also paragraphs 5.75 and 6.78).

3.65. On the issue of prices, the executive management made recommendations to the board, taking account of factors such as costs, inflation and market conditions. Management's recommendations were usually adopted. SIS's policy was to contain price increases below the level of inflation, indeed there was a provision in its standard terms and conditions which entitled a customer to terminate its supply contract if any price increase exceeded the rate of inflation. This provision, SIS said, reflected SIS's sensitivity to its customers' costs and to the competition law constraints against excessive pricing by dominant suppliers with dependent customers.

3.66. The structure of SIS's board is governed by its Articles. These provide that any shareholder owning 10 per cent or more of the issued share capital can appoint (and remove) a director, as can the Tote and the RCA whether or not they hold 10 per cent. The other shareholders can appoint (and remove) one director for each 10 per cent that they jointly hold. Furthermore the company may, by ordinary resolution, appoint additional directors.

3.67. The current board consists of nine directors. Four have been appointed by companies having a shareholding of 10 per cent or more, including one by Ladbroke and another by William Hill. There are two directors appointed by the Tote and the RCA, and the board appointed three other directors (a non-executive Chairman, an independent non-executive director and the Chief Executive). Prior to the Coral merger there was a tenth member of the board appointed by Bass, but the director concerned stepped down following Bass's cessation as a shareholder. SIS told us that senior operational staff appointments were made without specific reference to the board, which tended not to intervene in the day-to-day management of the business.

3.68. SIS has other activities which are increasingly important as new sources of revenue:

- (a) SISLink: this provides satellite news-gathering links services for collection of live television pictures from locations around the world. It was used, for example, during coverage of the 1997 General Election.
- (b) The Racing Channel: launched in November 1995, this is a version of the televised service delivered to shops but with less concentration on the betting element. The service is provided to domestic subscribers and at the time of our inquiry negotiations were being conducted for the service's extension to pubs and clubs. It does not cover greyhound races and the volume of horse-racing broadcasts is less than the main service to bookmakers. It also excludes races covered by the network broadcasters.

3.69. We were told of a recent case in which there had been disagreement within the board and where the question of conflicts of interest had arisen. This concerned the commercial exploitation of the Racing Channel by its extension to pubs and clubs. In April 1998 the board had voted to approve commercial exploitation subject to the RCA extending the terms of the channel's rights from 2000 to 2002. (This proviso stemmed from a concern that, while SIS had funded the channel's start-up losses, the RCA had benefited from royalty revenues from the outset. The extension of the rights was seen by some directors as necessary to achieve an equality of commitment to the channel as between SIS and the RCA.) The director appointed by the RCA had been the only one to vote against the April motion; this was not because he opposed commercial exploitation but because, as he had warned the board, the likelihood of the RCA agreeing to extend the rights was remote.

3.70. [

Details omitted. See note on page iv.

[

]

3.71. Since, as a result of the merger, Ladbroke now owns over 20 per cent of the shares of SIS it expects to be entitled, in accordance with the relevant accounting standard, to account for its share of SIS's profits in its own profit and loss account. Hitherto it has been able to account only for dividends received from the company. Taking, for illustrative purposes, SIS's results from the year to March 1997 (see paragraph 3.62), Ladbroke was able to show its share of SIS dividends deriving from its 17.8 per cent holding, namely £1.4 million. Had it already held the 22.8 per cent holding which it has achieved as a result of the merger, it would have received dividends of £1.8 million but its share of SIS's profits would have been £5.4 million.

Bookmakers' Afternoon Greyhound Services Limited

3.72. BAGS, a company limited by guarantee, was established about 30 years ago by the leading bookmakers. Its purpose was to arrange greyhound racing on a fee-paying basis for off-course betting at times when there might be no other racing (see also paragraphs 4.103 to 4.109 and 5.39). Its members are bookmakers and whilst new members are subject to being accepted by the BAGS board, to date no applications have been turned down. Ladbroke, a leading BAGS member, controls greyhound tracks that provide a significant proportion of BAGS race meetings (see paragraphs 3.76, 4.100 to 4.102 and 4.108).

3.73. During the year to 31 October 1997 BAGS staged 873 greyhound-racing meetings, including 11 standby meetings called to replace abandoned horse-race fixtures and 24 Thursday lunchtime meetings. For 1997/98 the BAGS programme consists of 877 greyhound-racing meetings involving some 9,600 races (see Table 4.7).

3.74. BAGS is managed by a board of directors, who are not remunerated for their duties, which meets roughly three times a year. At 31 October 1997 there were ten directors, each of whom is employed by a member company who is a bookmaker. There is a director from each of Ladbroke, Coral and William Hill. A decision on the future of the Coral director has been deferred pending the outcome of our inquiry. Under the Articles board decisions are on a straight majority basis. The Articles provide for voting at members' meetings, however, to be weighted according to the number of LBOs owned. Table 3.27 lists the five largest members and their LBOs, provided by BAGS, and also shows the number of betting shops owned by the other members grouped into three size bands. It emerges from this list that the combined Ladbroke/Coral, having over half the total number of LBOs owned by member firms, is in a position to exercise effective control of BAGS. BAGS told us, however, that the provision for voting according to number of LBOs had never been used and that the members of the present board were probably unaware of its existence.

TABLE 3.27 Summary of membership of BAGS

	<i>Number of members</i>	<i>Number of LBOs*†</i>	<i>Percentage of LBOs</i>	<i>Directors</i>
Ladbroke	1	1,926	37	1
Coral	1	844	16	1
William Hill	1	1,526	29	1
Stanley	1	479	9	1
Tote	1	219	4	1
	5	4,994	95	5
Bookmakers with:				
21–100 LBOs	4	178	4	3
6–20 LBOs	7	70	1	0
1–5 LBOs	12	29	0	2
	28	5,271	100	10

Source: BAGS.

*Before the merger and the agreement between Ladbroke and Tote Bookmakers covering the sale of LBOs.

†BAGS told us that its records of the number of LBOs operated by each member might not always reflect all acquisitions or closures but that any discrepancies would be small (see Table 4.16 for numbers of LBOs as provided by the companies).

3.75. BAGS has close working links with SIS, which relays live pictures of BAGS races to LBOs together with a commentary and text service (Racing Data also provides a text service to LBOs). BAGS has a secretariat staff of five and shares offices with BOLA. The profit and loss account of BAGS for the year ended 31 October 1997 shows income of £5.47 million of which £5.44 million was paid by SIS for securing that it had the necessary access to BAGS meetings and other rights. SIS in turn recoups these costs from its bookmaker customers as part of its main charging structure. Before the arrangement with SIS was formalized, BAGS charged bookmakers directly for the services which they received from BAGS, but it found problems and delays with collecting its charges. The fee payable by SIS is negotiated annually at a level equivalent to BAGS' forecast total expenditure. BAGS understands that SIS does not make a profit directly from its coverage of BAGS races, which is included with its total service to betting offices. BAGS is not intended to make profits (although over the years it has accumulated a reserve of some £127,000) and its expenses in 1996/97, predominantly fees payable to greyhound tracks for staging races and for television rights, also amounted to £5.47 million. Its balance sheet at 31 October 1997 consisted of cash of £116,000 and other net assets amounting to £11,000. BAGS is not empowered to make distributions to its members. The BGRB told us that the income from BAGS fees was important to those tracks which held BAGS meetings.

3.76. BAGS told us that no BAGS board member connected with a track-owning company took part in decisions over fixture tendering (see paragraph 5.43). Nevertheless, we established that the BAGS board member employed by Ladbroke attended the BAGS board meeting on 29 July 1997 at which the award of the 1997/98 contracts was decided. He did not declare an interest and stayed in the room while fixture tendering was being discussed, although BAGS' management told us that he took no part in that discussion (see also paragraph 6.84).