A macro-economic review of the UK local media sector
A report prepared for Ofcom
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OVERVIEW: THE CHALLENGES FACED BY LOCAL MEDIA
UK advertising expenditure by media

...the UK advertising market has experienced low growth from 1998 to 2008, with spend on radio and regional newspapers decreasing over the period...

UK advertising expenditure, 1998 to 2008 (at 2000 prices)

Source: Advertising Association
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THE EMERGING ONLINE THREAT

Online advertising by type

Although “pure” classified advertising online is dwarfed by paid-for-search it now amounts for £0.6 billion, directly cannibalising printed press revenues streams…

Internet advertising spend by type at current prices, 2000 to 2008

£ (Billions)

Classified online as distinct from search and display has been growing exceptionally strongly representing a significant threat to traditional print advertising revenue streams

Source: Advertising Association, IAB, PWC, WARC, Oliver & Ohlbaum Analysis
THE EMERGING ONLINE THREAT
Online advertising revenues by type

…the traditional printed press classified advertising categories of recruitment, property and automotive account for 46% of all online advertising spend…

Recruitment has seen the strongest shift towards online spending, accounting for 26% of all non-search online advertising

- The traditional newspaper print classified categories are among the strongest online movers leading to a rapid cannibalisation of print revenues since 2004
- However, property and automotive advertisers are traditionally bigger display advertisers than recruitment and so shift online may be slower as press retains a stronger hold on display advertising value and volumes

Share of Internet advertising spend (non-search) by sector, H2 2007

Source: Advertising Association, IAB, PWC, WARC, Oliver & Ohlbaum Analysis
THE EMERGING ONLINE THREAT
Recruitment classified advertising

…there is evidence of price pressure on the total recruitment classified advertising market and regional press’ share is falling rapidly…

UK classified recruitment advertising spend by type at current prices, 2002 to 2008

- Recruitment classified has seen the largest proportional shift online of all key industry categories.
  - There is significant evidence of downwards price pressure shrinking the entire recruitment classified market
  - This is due to high levels of online supply of classified recruitment advertising inventory
  - In 2004-2005 it appeared as though regional press was holding its share of all recruitment classified advertising but since then the media’s loss of share has been rapid
  - Regional printed press have seen annual declined in recruitment classified of -12% since 2004

Source: Advertising Association, IAB, PWC, WARC, Oliver & Ohlbaum Analysis
THE EMERGING ONLINE THREAT

Online recruitment classified by provider

...online specialist providers account for 65% of all online classified recruitment advertising while regional newspaper owned online sites have struggled to gain market share...

Online recruitment advertising spend by type of online provider at current prices, 2002 to 2008

- Regional newspaper online sites have managed to grow recruitment classified revenues strongly since 2004
- However, regional newspaper groups have failed to significantly take market share from online specialist provider websites
- The promise of being able to dominate online recruitment classified advertising by offering a joined up online-print product to advertisers as thus far not materialised

Source: Advertising Association, IAB, PWC, WARC, Oliver & Ohlbaum Analysis
...there are three national directories providers and a large number of local providers ...

Number of directories by publisher in the UK, 2006

Source: Competition Commission, O&O Analysis
LOCAL CLASSIFIED DIRECTORIES
Directories providers

...major directories providers focus on larger coverage regions leaving some opportunities for specialist locally targeted providers...

Average directory circulation by provider, 2006

Note: Kingston is effectively the incumbent telco in Hull and so BT is not present in this market

Source: Oliver & Ohlbaum Analysis
LOCAL CLASSIFIED DIRECTORIES

Market size

…but beyond the major three players, the directories market is very small leaving little room for local newspaper groups to diversify…

UK consumer directories advertising income, 2006

<table>
<thead>
<tr>
<th>Category</th>
<th>£ (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>944</td>
</tr>
<tr>
<td>Yell</td>
<td>699</td>
</tr>
<tr>
<td>Thomson</td>
<td>120</td>
</tr>
<tr>
<td>BT</td>
<td>95</td>
</tr>
<tr>
<td>Other Local</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: Advertising Association, company accounts, DTI, O&O Analysis
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...the main levers for revenue generation remain circulation (cover price) and advertising; other revenue streams are areas of focus for newspapers but remain relatively small (e.g. product offers and events) ...

Newspaper revenue drivers
...the press supply chain a rigidly linear process from advertising sales and editorial through to distribution...
…the flexibility to reduce costs in the newspaper supply chain are limited to editorial, ad sales and overhead functions while printing, newsprint and distribution costs are largely outside the short-term control of newspaper groups…

### Key newspaper supply chain functions

<table>
<thead>
<tr>
<th>FUNCTION</th>
<th>DEFINITION</th>
<th>TYPICAL % COSTS</th>
<th>KEY RECENT TRENDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>EDITORIAL</td>
<td>▪ Principal newsgathering operation&lt;br&gt;▪ Core staff of journalists, reporters, sub-editors and editorial staff</td>
<td>18%</td>
<td>▪ Increasing sharing of editorial content across local titles and also pressure on publisher margins have led to dramatic cuts in editorial expenditure&lt;br&gt;▪ Increasing centralisation of editorial staff around core regional hub titles</td>
</tr>
<tr>
<td>ADVERTISING SALES</td>
<td>▪ Teams selling classified and display advertising</td>
<td>18%</td>
<td>▪ Classified advertising telephone sales are increasingly centralised across a region&lt;br&gt;▪ Display advertising still sold by dispersed field teams</td>
</tr>
<tr>
<td>PRODUCTION</td>
<td>▪ Small team putting together editorial and advertising content to create newspaper book layout</td>
<td>2%</td>
<td>▪ Desktop publishing and templated advertising graphics have dramatically reduced the labour costs required to amalgamate the book</td>
</tr>
<tr>
<td>NEWSPRINT</td>
<td>▪ Key paper raw materials&lt;br&gt;▪ A global commodity</td>
<td>14%</td>
<td>▪ Global commodity costs have risen sharply due to reduced global supply and industry consolidation&lt;br&gt;▪ Reduced demand may see prices fall in 2009</td>
</tr>
<tr>
<td>PRE-PRESS &amp; PRINTING</td>
<td>▪ Print run plate preparation&lt;br&gt;▪ Core industrial printing operation&lt;br&gt;▪ Asset utilisation is key</td>
<td>14%</td>
<td>▪ Largely a fixed cost&lt;br&gt;▪ Heavy capital investment in all colour presses between 2000 and 2007</td>
</tr>
<tr>
<td>DISTRIBUTION</td>
<td>▪ In-store, door-drops and street distribution&lt;br&gt;▪ Local monopoly distributors</td>
<td>17%</td>
<td>▪ Wholesale and newsagent fees account for 50% of cover price typically&lt;br&gt;▪ Local monopoly distribution still predominant</td>
</tr>
<tr>
<td>OVERHEADS</td>
<td>▪ Core back-office functions&lt;br&gt;▪ Establishment / premises costs</td>
<td>18%</td>
<td>▪ Significant centralisation of key operations around major regional city title hubs&lt;br&gt;▪ Closure of satellite offices</td>
</tr>
</tbody>
</table>

Source: Company Accounts, Oliver & Ohlbaum, Analysis
THE NEWSPAPER SUPPLY CHAIN

Editorial – small local title

…the vast majority of the editorial cost for a smaller local regional title is the cost of internal reporters, sub-editors and an editor…

Typical editorial value chain and costs by type for a small local weekly title

- **INTERNAL EDITORIAL STAFF**
  - 1 EDITOR / 2 SUB EDITORS
  - 4-7 REPORTERS
  - 1 FREELANCE PHOTOGRAPHER
  - £200k - £500k COST PER YEAR

- **AGENCY CONTENT**
  - TYPICALLY PRESS ASSOCIATION
  - USUALLY COURT COPY OR CELEBRITY NEWS
  - £10k PER YEAR MAXIMUM COST ON A STORY BY STORY BASIS

- **SYNDICATED CONTENT**
  - OPINION PIECES AND REGULAR COLUMNISTS
  - £10k - £15k PER YEAR

- **SPORT CONTENT**
  - PROVIDED BY CENTRAL GROUP REGIONAL HUB TEAM

**TOTAL EDITORIAL COST:**

£200k – £700k PER YEAR, DEPENDING ON TITLE SIZE

Source: Oliver & Ohlbaum Analysis
...the vast majority of editorial cost that a major regional daily title incurs is a large team of reporters to provide full coverage of a large range of stories, typically across a large urban area or county...

Typical editorial value chain and costs by type for a large regional daily title

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**INTERNAL EDITORIAL STAFF**
- 1 EDITOR / 1 DEPUTY EDITOR
- 5-10 SUB EDITORS
- 30-90 REPORTERS
- £1.5m - £8m COST PER YEAR

**AGENCY CONTENT**
- TYPICALLY PRESS ASSOCIATION
- MAJOR NATIONAL AND INTERNATIONAL NEWS STORIES
- £150k - £200k PER YEAR
- CENTRAL CONTRACT

**SYNDICATED CONTENT**
- OPINION PEICES AND REGULAR COLUMNISTS
- CULTURE NEWS AND EVENTS
- £50k PER YEAR

**SPORT CONTENT**
- 5-10 PEOPLE SERVING ALL REGIONAL TITLES
- £200k - £300k PER YEAR

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**TOTAL EDITORIAL COST:**
£2m - £10m PER YEAR, DEPENDING ON TITLE SIZE
THE NEWSPAPER SUPPLY CHAIN
Advertising sales – local sales

…local advertising sales teams are generally split between dispersed field sales handling larger display clients and telephone sales teams handling smaller display and classified advertisers…

Regional newspaper groups: typical local sales structure and costs

<table>
<thead>
<tr>
<th></th>
<th>FIELD SALES</th>
<th>TELEPHONE SALES</th>
</tr>
</thead>
<tbody>
<tr>
<td>TYPE OF CLIENTS HANDLED</td>
<td>Handle larger display clients, Often property, motors, Large local run-of-paper clients</td>
<td>Recruitment and other classified, Smaller display clients</td>
</tr>
<tr>
<td>AVERAGE TEAM SIZE</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SMALL WEEKLY TITLE</td>
<td>1-3 people</td>
<td>2-3 people</td>
</tr>
<tr>
<td>MAJOR DAILY TITLE</td>
<td>30-40 people</td>
<td>20-40 people</td>
</tr>
<tr>
<td>AVERAGE TEAM COST</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SMALL WEEKLY TITLE</td>
<td>£0.2 million / year</td>
<td>£0.2 million / year</td>
</tr>
<tr>
<td>MAJOR DAILY TITLE</td>
<td>£2-3 million / year</td>
<td>£2-3 million / year</td>
</tr>
</tbody>
</table>

Source: Oliver & Ohlbaum, Analysis
THE NEWSPAPER SUPPLY CHAIN

Pre-press

...pre-press, the process that prepares plates and image carriers for printing a specific edition of a paper, has seen a significant reduction in cost in recent years

Estimated average regional newspaper pre-press costs per page, 2000 to 2008

Pre-press costs have fallen considerably in recent years

- Less than a decade ago, the pre-press operation of a major regional printing group hub would have required around 60-100 people to print 2000 pages per week but the total is now around 30 people
- Desktop publishing and automation of almost all parts of the process have reduced the physical labour costs involved in pre-press
- Desktop publishing templates have allowed advertiser creative staff/agencies to prepare advertising copy themselves ready for inclusion at the pre-press stage
- 70-80% of all advertising is now provided by advertisers ready to include in the production/prepress process

Source: Oliver & Ohlbaum Analysis
THE NEWSPAPER SUPPLY CHAIN

Newsprint

...global newsprint prices rose by around 30% in 2008 putting additional pressure on the cost bases of local newspaper groups, but this cost pressure is likely to ease in 2009/2010…

Global newsprint prices, January 2008 to March 2009

Newsprint is a global commodity, with pricing outside the control of individual groups.

- It is likely that newsprint prices will fall in 2009/2010 as global demand for newsprint falls through the recession
- The strong upward momentum was driven mainly by industry consolidation among major players in North America, which supply one third of the world’s newsprint production
- The gloomy global economic outlook has resulted in a demand slowdown for newsprint – putting downward pressure on prices
- Publishers closing titles, reducing pagination and moving titles from daily to weekly should reduce pulp prices further

Source: Oliver & Ohlbaum Analysis
THE NEWSPAPER SUPPLY CHAIN

Distribution

…distribution of local newspapers is extremely expensive due to the fragmented nature of distribution outlets and also the cost of providing a free-sheet to every home in a given area…

Average newspaper gross circulation revenue share by company – based on 40p typical cover price

A newspaper publisher typically retains only 50% of the cover price of a paid for newspaper

- Wholesale costs are high, given the dispersed nature of outlets and also the regulated local monopoly provision of distribution services in any given region
- 80% of sales are typically through 20% of outlets
- Distributors often generate additional revenue by the insertion of leaflets into the newspapers they distribute but this business model is currently under severe pressure

Source: Oliver & Ohlbaum
THE ECONOMIC PERFORMANCE OF THE LOCAL PRESS

Regional newspaper advertising

…the largest long-term structural decline in classified has thus far been in the recruitment sector …

Regional newspapers advertising revenue by type, 1998 - 2008

£ (Billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Display</th>
<th>Local Display</th>
<th>Recruitment classified</th>
<th>Other Classified</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>0.2</td>
<td>0.3</td>
<td>0.6</td>
<td>1.0</td>
<td>2.3</td>
</tr>
<tr>
<td>1999</td>
<td>0.2</td>
<td>0.2</td>
<td>0.6</td>
<td>1.1</td>
<td>2.5</td>
</tr>
<tr>
<td>2000</td>
<td>0.3</td>
<td>0.3</td>
<td>0.7</td>
<td>1.1</td>
<td>2.5</td>
</tr>
<tr>
<td>2001</td>
<td>0.3</td>
<td>0.3</td>
<td>0.7</td>
<td>1.2</td>
<td>2.5</td>
</tr>
<tr>
<td>2002</td>
<td>0.3</td>
<td>0.3</td>
<td>0.8</td>
<td>1.2</td>
<td>2.5</td>
</tr>
<tr>
<td>2003</td>
<td>0.3</td>
<td>0.3</td>
<td>0.8</td>
<td>1.2</td>
<td>2.5</td>
</tr>
<tr>
<td>2004</td>
<td>0.3</td>
<td>0.3</td>
<td>0.9</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>2005</td>
<td>0.3</td>
<td>0.3</td>
<td>0.7</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>2006</td>
<td>0.3</td>
<td>0.3</td>
<td>0.6</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>2007</td>
<td>0.3</td>
<td>0.3</td>
<td>0.6</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>2008</td>
<td>0.3</td>
<td>0.3</td>
<td>0.5</td>
<td>1.3</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: Advertising Association
Recruitment, traditionally the main driver of classified advertising growth, is highly cyclical but a clear structural change has occurred since 2004 with recruitment, automotive and other classified entering decline despite strong GDP growth to 2007…

UK newspaper classified advertising by type at constant (2000) prices, 1970 to 2008

£ (Millions)

Source: Advertising Association
Closures of local newspapers in the UK are the result of a shakeout – the newspapers closing are generally weaker titles in competitive markets and titles remain from other publishers or are consolidated.

Analysis of reason for closure of local newspapers, January 2008 to July 2009

- **TOTAL**: 66
- **PAID WEEKLY**:
  - Publisher has other stronger titles in market: 17
  - Consolidated titles: 9
  - Another publisher has stronger titles in market: 31
- **FREESHEETS**:
  - Publisher has other stronger titles in market: 4
  - Consolidated titles: 2
  - Another publisher has stronger titles in market: 3

Of all the local newspapers that have closed since the start of 2008, only one (in Castle Donnington) has left a town or region without a specifically focused title:

- **Castle Donnington Nu News** was published by Trinity, was a weekly free sheet and closed on the 1st October 2008.
- The paper circulated to only 1600 homes out of the 6000 homes in the town.
- Castle Donnington no longer has a paper targeting specifically the town with the closure of the weekly free sheet.
- With only 12,000 inhabitants the town is covered by other titles centred on Derby, Loughborough and Nottingham.

*some titles published every two weeks

Source: Newspaper Society, Guardian Online, Press Group Announcements, Oliver & Ohlbaum Analysis
THE ECONOMIC PERFORMANCE OF THE LOCAL PRESS

Newspaper closures – recent examples

…more than 50 local newspapers have closed in the last 18 months but almost all of the closures are of weak titles in markets served by more than one local newspaper…

Selected local newspaper closures, 2007 to 2008

<table>
<thead>
<tr>
<th>TITLE CLOSED</th>
<th>OWNER</th>
<th>POSITION IN MARKET</th>
<th>REASON FOR CLOSURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Esher News and Mail</td>
<td>Surrey &amp; Berkshire / GMG</td>
<td>5</td>
<td>Weak title in market already served by larger GMG, Trinity and Newsquest titles</td>
</tr>
<tr>
<td>Aldershot Mail</td>
<td>Surrey &amp; Berkshire / GMG</td>
<td>2</td>
<td>Merged with GMG’s Aldershot News title</td>
</tr>
<tr>
<td>Bath Observer</td>
<td>Northcliffe</td>
<td>1</td>
<td>Northcliffe also own the only other major title – paid-for Bath Chronicle in same market</td>
</tr>
<tr>
<td>Cambridge Weekly News</td>
<td>Iliffe</td>
<td>1</td>
<td>Iliffe consolidated with Cambridge Crier free-weekly title</td>
</tr>
<tr>
<td>Preston &amp; Leyland Citizen</td>
<td>Newsquest</td>
<td>1/2</td>
<td>JP own the big evening title and major weekly free-sheet</td>
</tr>
<tr>
<td>Lancaster &amp; Morcombe Citizen</td>
<td>Newsquest</td>
<td>1/2</td>
<td>Major title competition from JP with leading paid weekly and similar sized weekly free-sheet</td>
</tr>
<tr>
<td>Blackpool Citizen</td>
<td>Newsquest</td>
<td>1/2</td>
<td>Major title competition from JP with leading paid weekly and similar sized weekly free-sheet</td>
</tr>
<tr>
<td>Huyton &amp; Roby Star</td>
<td>Trinity</td>
<td>4</td>
<td>Weak title in Trinity dominated market served by several other titles</td>
</tr>
<tr>
<td>South Wirral News</td>
<td>Trinity</td>
<td>4</td>
<td>Weak title in Trinity dominated market served by several other titles</td>
</tr>
<tr>
<td>N. Yorkshire Herald &amp; Post</td>
<td>Trinity</td>
<td>14</td>
<td>Weak title in market served by much bigger metropolitan titles</td>
</tr>
<tr>
<td>Peterborough Herald &amp; Post</td>
<td>Trinity</td>
<td>1</td>
<td>Strong weekly title but in a market dominated by the JP paid-for evening titles and weekly free-sheet</td>
</tr>
<tr>
<td>Stamford Herald &amp; Post</td>
<td>Trinity</td>
<td>2</td>
<td>Weaker titles up against stronger paid-for daily</td>
</tr>
</tbody>
</table>

Source: Newspaper Society, Oliver and Ohlbaum Analysis
THE ECONOMIC PERFORMANCE OF THE LOCAL PRESS
Long term sustainability – base case

Regional press revenues will be heavily hit during the recession with only a partial recovery as the economic cycle returns to growth

UK regional press revenues by type, 1998 to 2013 (nominal terms)

Regional press revenues could recover somewhat as the economic cycle returns to growth

- Industry revenues are forecast to fall by £800 million from 2007 to 2010
- This fall represents a decline of 24% from 2007 to 2010
- While there could be some recovery after the recession, this will only be partial as structural declines continue
- The base case recovery assumes:
  - Recovery in property classified advertising if property transactions increase with any economic recovery
  - Ongoing decline in recruitment and motors classified advertising due to sustained online competition
  - A recovery in display advertising in line with any wider economic recovery
  - Maintaining circulation revenues through cover price rises to counter circulation declines

Source: Advertising Association, Oliver & Ohlbaum Analysis
Regional press revenues will be heavily hit during the recession with only a partial recovery as the economic cycle returns to growth.

UK regional press revenues by type, 1998 to 2013 (nominal terms)

Regional press revenues could recover somewhat as the economic cycle returns to growth:

- Industry revenues are forecast to fall by £900 million from 2007 to 2010
- This fall represents a decline of 27% from 2007 to 2010
- The low case assumes that there will be little to no recovery after the recession due to structural changes in the industry, e.g. the rise of online competition for classified advertising
- The low case assumes:
  - Limited to no recovery in classified advertising overall due to sustained online competition
  - Continued declines in display advertising despite any economic recovery
  - Slight circulation revenues declines to represent cover price rises not countering circulation declines

Source: Advertising Association, Oliver & Ohlbaum Analysis
In order for low case margins of around 10% by 2013 to be realised, steeper declines would need to be experienced in most revenue lines (rather than just one or two)

Impact of each individual low case revenue line on overall industry margin in 2013 (base case industry margin = 15%)

<table>
<thead>
<tr>
<th>REVENUE LINE</th>
<th>BASE CASE CAGR 2007 TO 2013</th>
<th>LOW CASE CAGR 2007 TO 2013</th>
<th>INDUSTRY MARGIN 2013 (WITH LOW CASE REVENUE LINE*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIRCULATION</td>
<td>-1%</td>
<td>-4%</td>
<td>14%</td>
</tr>
<tr>
<td>DISPLAY</td>
<td>-2%</td>
<td>-5%</td>
<td>12%</td>
</tr>
<tr>
<td>RECRUITMENT</td>
<td>-10%</td>
<td>-16%</td>
<td>13%</td>
</tr>
<tr>
<td>PROPERTY</td>
<td>-3%</td>
<td>-9%</td>
<td>11%</td>
</tr>
<tr>
<td>AUTOMOTIVE</td>
<td>-12%</td>
<td>-19%</td>
<td>15%</td>
</tr>
<tr>
<td>OTHER</td>
<td>-3%</td>
<td>-5%</td>
<td>15%</td>
</tr>
</tbody>
</table>

*and related proportionate cost reduction
Source: Oliver & Ohlbaum Analysis
THE ECONOMIC PERFORMANCE OF THE LOCAL PRESS
Industry profitability – base case

While the recession will see margins fall dramatically, the industry could remain highly profitable but at EBIT margin levels of 10-15% rather than 25-30% historically seen.

Base case scenario: regional press revenues, costs, EBIT and EBIT margin, 2006 to 2013 (nominal terms)

The recession is hitting regional press groups hard with a resulting significant drop in EBIT margin expected under the base case scenario:

- Margins will halve through the recession but the industry will remain in profit.
- Long term structural decline will continue to see margins squeezed in the medium term.
- However, as the economy recovers after recession margin levels also recover but never to historic high levels seen between 2000 and 2007.
- Under base case assumptions, average industry profitability could be 15% in 2013.
- Major restructures and cost cutting measures could allow major regional press groups to maintain these margins for the next 5-10 years.

Source: Company accounts, Advertising Association, Oliver & Ohlbaum Analysis
O&O’s low case forecast suggests that average industry margins could fall to around 10% by 2013

O&O’s low case forecast for the regional press industry implies little recovery after the recession combined with continued structural change.

- This low case forecasts a more limited recovery in property classified advertising – and slower recessional recovery in other lines.
- All other key revenue lines are forecast to experience more rapid decline to 2013.
- However, under such conditions it is likely that the industry would continue to cut costs, so some additional cost reduction has been included.
- O&O’s low case forecast assumes annual industry cost cuts of 5% per year from 2009 to 2013.

Source: Company accounts, Advertising Association, Oliver & Ohlbaum Analysis
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- How is local radio performing?

Section 5: Opportunities for synergies

- Cross media synergies: local and regional press and local commercial radio
- Television and local and regional press
- Intra-industry press
THE LOCAL RADIO SUPPLY CHAIN
Supply of programming and news output

...radio programming is usually produced directly by each station with local news also produced locally while national and international news is provided at low cost by a third party...

Typical radio station news supply value chain

- Local news
  - Produced internally and also presented by a small team of local reporter/presenters
  - Costs range from £200-250k/year for large city stations to £50-150k/year for smaller stations
  - 2-5 local reporters and presenters

- National / International news
  - News feed acquired from third party
  - Costs are approximately £10k per year
  - Main providers are Sky News and IRN

News programming is low cost on local radio, usually representing no more than 15%-20% of total programming costs

- Local news is produced internally and also presented by a small team of local reporter/presenters
- National and international news is extremely cheap and provided by one of two major radio news providers in the UK

Source: Oliver & Ohlbaum
THE LOCAL RADIO SUPPLY CHAIN
Increasing prominence of national brands

…an increasing focus on fewer major national brands is likely to increase the degree of national networked programming and reduce the focus on local output within some groups. However, key local personality, news, traffic & travel is likely to remain vital for local competitive differentiation at peak listening hours…

Source: Oliver & Ohlbaum
THE LOCAL RADIO SUPPLY CHAIN
Radio station costs

…across the UK industry, radio programming costs represent around only 20-40% of revenues, limiting the impact of content cost sharing with other media such as newspapers…

UK Radio stations by type: average costs and EBITDA as a proportion of revenues, 2006 / 2007

News programming only represents a very small proportion of the overall costs of running a radio station

- There are therefore only limited potential cost benefits for a radio station looking to share newsgathering costs with a local newspaper
- Key areas of cost reduction for radio stations with pressure on profits are:
  - Ad sales
  - Ad sales commission
  - Local news production
  - Marketing spend

Source: Oliver & Ohlbaum Analysis
COMMERCIAL RADIO CONSUMPTION TRENDS
Listening by station type

…since the end of 2002 the share of independent local radio services (ILR) has been declining faced with competition from national rivals and the BBC’s array of pop music stations. Last year saw a slight recovery for the ILR brands…

Quarterly audience listening share, June ‘01 – Dec ‘08

BBC’s upward trajectory to 2008

- Following the launch of the BBC’s digital stations, the broadcaster has seen a significant increase in audience share for its pop music stations at the expense of commercial ILR stations.

- National radio stations share has grown by 6 per cent year on year while BBC local radio has seen a significant decline in listening.

- In the last three quarters there has been a slight recovery for local commercial stations (ILR) while the BBC pop music stations have seen a significant fall in share of overall listening hours.

Outlook for the future

- Shift of listening away from local stations towards national networks over the last few years.

- Quasi-national and networked shows from commercial sector may drive audiences back?

- Big name talent networked across a number of branded stations may reinvigorate competition between BBC pop stations and ILR.

- BBC Speech challenged by proposed LBC-like national stations?

Source: Rajar, Oliver & Ohlbaum
Radio industry revenue has been broadly flat since the start of the decade – national advertising has declined slightly (replaced by increased S&P); local advertising has been more resilient.

Broad, all adults advertising still dominates – radio has not been able to monetise niche audiences (with the exception of Classic FM, specialist radio stations have struggled).

Older audiences are not attractive to radio advertisers, who can obtain older impacts at low cost on TV (where the volume of impacts has been increasing and price falling).

The internet has not cannibalised radio (or TV) advertising – advertisers have not switched spend. It has, however, caused a rethink of advertising and may have depressed growth in the overall display advertising segment.

Share deals are key to the industry and do influence advertiser choices – the big groups dominate spending.

The London market is unduly influential on advertiser choices – agencies choose familiar options, and are less influenced by performance elsewhere in the UK.

We forecast that after a sharp downturn (followed by recovery), the advertising market will return to slow growth – driven by national advertisers (and a renewed focus on radio catalysed by the Global/GCap portfolio).

*Note this growth rate is skewed slightly by S&P contribution in 2000

Source: Oliver & Ohlbaum adjustment of RAB, AA and Ofcom data
... ILR stations tend to generate higher advertising yields (revenue per listener hour) than their regional and national counterparts...

Revenue per listener hour and average weekly reach by station, 06/07*

![Graph showing revenue per listener hour and average weekly reach by station type]

The ILR Premium

Heritage ILR stations premium on the market average is down to a number of factors:

- **Local** – compared to regional and national counterparts there is far less wastage associated with advertising on an ILR. Consequently ILRs tend to generate a relatively higher proportion of their revenues from local advertisers who can be sure they're targeting a local audience.

- **Habitual/legacy** – ILR stations tend to have long-lasting and strong relationships with local advertisers and media planning/buying agencies.

- **National** – Being the local market leader (which typically is the heritage ILR station) holds significant weight with national ad agencies who may be placing spend across a bundle of brands. Within this, being ‘No. 1’ in London can have a profound effect on the volume of spend distributed to other heritage ILRs within a group.

*Note: revenue includes S&P and all airtime revenues (net of agency commission)
Source: Rajar, Nielsen, Company Accounts, Oliver & Ohlbaum
… advertisers place a premium on reach of a broad 20 to 40 age audience within any given local market…

**Revenue per listener hour and average age of listenership, 06/07**

*Note: revenue includes S&P and all airtime revenues (net of agency commission)
Source: Rajar, Nielsen, Company Accounts, Oliver & Ohlbaum*
HOW IS LOCAL RADIO PERFORMING?
Profitability by station type

…the smaller the station, the tougher the commercial radio business model – national advertisers are more focused on the main large urban centers and local advertising markets are not big enough to sustain small stations…

Average station EBITDA by station type, 2007

*Note: Sample of 60 stations
Source: Companies house, Oliver & Ohlbaum Analysis
Contents

- Section 1: Advertising Overview
  - UK advertising revenue by type

- Section 2: Competition for local advertising revenues
  - The emerging threat of online media
  - Local classified directories

Section 3: The local and regional press
- How is the UK newspaper industry structured?
- The economics of the local press value chain
- Macro-economic performance of the local press
- Newspaper closures
- Scenarios for press

Section 4: Local commercial radio
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- Cross media synergies: local and regional press and local commercial radio
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CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?

Summary

Cost synergies are limited while there might only be a very limited revenue upside from major group mergers

Given that both radio stations and newspapers output local news and undertake newsgathering it is possible that synergies through cross-media mergers could be achieved. In reality the benefits are minimal.

Intra-media mergers could, however, lead to cost synergies that improve the economics of marginal titles and stations.

Equally, most regional newspaper groups are already dominant in print in their markets but compete heavily with other media, especially online, for revenues and so mergers are unlikely to bring any significant revenue synergies.

There are relatively few cost saving to be made from cross media mergers

- Radio stations generally spend only around 5-10% of costs on news programming costs
- Not even all of this would be saved through merger with a newspaper as presenters are still required
- However, there are modest cost savings that could be achieved by merging regional newspaper groups together
- In practice this might make smaller/marginal titles more viable
- These saving are likely to be mainly derived from overheads, printing and ad sales synergies
- The cost of news gathering for regional / local TV news channels represents only a modest proportion of the overall costs of running a TV station

It is debatable whether there are any revenue synergies that can be exploited from either cross-media mergers or major group regional mergers

- Regional press accounts for only a minority of overall local advertising spend in local markets
  - Changes to cross-media ownership laws would probably not bring revenue synergies
- Only a small number of brands (10-20%) use only newspapers across key vertical categories
  - Newspapers probably have little pricing power in general
- However, where they offer unique reach and impact, especially in property and display, major group mergers and the removal of competition in specific local markets may provide a small amount of pricing power back to newspapers
  - O&O have modeled two scenarios for slight price increases in property classified and display but the revenue uplift over time is minimal
  - However, the impact on margins is somewhat greater as incremental revenues go straight to the bottom line but there is no meaningful medium-term protection from margin erosion due to structural change in the long run

Source: Oliver & Ohlbaum Analysis
CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?
Cost synergies: cross-media and intra-media

There are two types of cost synergies that local media owners might be able to take advantage of – cross-media consolidation and intra-media mergers

Possible merger synergies in local media markets

Source: Oliver & Ohlbaum Analysis
CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?
Cross-media cost synergies - radio value chain

Radio news programming is mostly generated internally through local journalists but low cost IRN feeds are used to obtain key national and regional headlines.

Typical radio station news supply value chain

- **CONTENT SOURCE**
  - IRN / SKY NEWS AUDIO PACKAGES (National news)
  - IRN / SKY NEWS STORY FEED (National news)
  - OTHER WIRES (Local news)
  - NEWSGATHERING (Limited)

- **CONTENT SPEND**
  - INTERNAL JOURNALISTS
  - SEND = £10k – £17k PER YEAR

- **ON AIR NEWS**
  - 95% OF RADIO NEWS SPEND IS ON INTERNAL STAFF
  - SPEND = £200k - £300k PER YEAR

- **TYPICALLY THE SAME STAFF**

News programming is low cost on local radio, usually representing no more than 15%-20% of total programming costs.

- Local news is produced internally and also presented by a small team of local reporter/presenters.
- National and international news is extremely cheap and provided by Sky news who are the sole provider of radio news in the UK.

Source: Oliver & Ohlbaum Analysis
Radio stations spend very little on news programming in comparative terms to local and regional newspapers limiting any upside for newspaper groups in exploiting any synergies.

Regional newspapers in Anglia spent £29m on editorial activities in 2008 while all 26 commercial radio stations in the region spent only £2.4m.

- Radio stations could benefit from access to the considerable newsgathering resources of regional press groups.
- Given that most radio station journalists also present on air, the cost synergy achievable from merger with a newspaper group is relatively small.
- However, the cost savings achievable are minimal in the context of the overall cost base of radio stations in the region.
- In terms of the combined cost base, saving 40% of radio news spend would only reduce total regional editorial / newsgathering costs by around 3% or around 1% of the total combined radio and press cost base.
At least one group already exploit radio and press newsgathering synergies in the greater Manchester region and so further merger synergies could only be enjoyed in other smaller metropolitan areas limiting the possible wider gain.

The North West has a highly competitive radio market with a strong supply of large city heritage ILR stations leading to a high comparative news programme spend compared to Anglia.

- One group already exploits synergies between newspaper and radio news spend
- Given that most radio station journalists also present on air, the cost synergy achievable from merger with a newspaper group is relatively small
- However, the cost savings achievable are minimal in the context of the overall cost base of radio stations in the region
- In terms of the combined cost base, saving 40% of radio news spend would only reduce total regional editorial/newsgathering costs by around 3% or around 1% of the total combined radio and press cost base.
CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?

Cross-media merger synergies – local TV news and newspapers

There are only a limited number of costs within the regional / local TV news value chain which can benefit from synergies with local newspapers

Regional TV newsgathering value chain and principal activities

Field Operations
Gathering news footage / material from the scene
- Correspondent
- Crew
- Footage
- Background / story

Infrastructure
The fixed assets required to handle multiple sources and produce news packages
- Hub / Traffic
- Newsroom
- Production Systems
- Edit
- Graphics

Programming
The assets required to produce news programming output
- Studio
- On-screen talent
- Gallery
- Playout

Dark shaded elements are where synergies can be exploited with a local newspaper:
- Synergies with Newspapers

There are only limited parts of the TV news value chain where synergies with local newspapers can be exploited. These related mainly to newsgathering activities.

Source: Oliver & Ohlbaum Analysis
CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?

Newspaper cost synergies – O&O assumptions

O&O has modelled the regional newspaper industry cost base by category and have reduced costs where synergies are most realistically achieved

Regional newspaper group merger cost synergies

<table>
<thead>
<tr>
<th>ISSUES</th>
<th>MODELLED ASSUMPTION OF COST REDUCTION (POST 2008)</th>
</tr>
</thead>
</table>
| PRINTING | • Geographical proximity of major groups’ distribution regions means the same presses might be used for more than one group  
• Reduced circulation and weekly title closures in the last five years has led to excess printing capacity across almost all groups | (10%) |
| OVERHEADS/MANAGEMENT | • There is considerable room to extract overheads costs in industry regional groups even before mergers  
• Replication of management functions across regions is feasible | (25%) |
| ADVERTISING SALES | • Advertising sales operations can certainly be reduced in size further through mergers across a region  
• Cost savings are most likely to be made through centralisation of telephone sales teams  
• These saving are most likely to come through reductions of classified teams rather than display field sales teams which tend to be more localised and on client site  
• Advertisers only need one point of contact for all press advertising | (30%) |

Source: Company Accounts, Oliver & Ohlbaum Analysis
CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?

Newspaper cost synergies - Anglia

Cost synergies through regional newspaper group mergers in Anglia would deliver an annual cost synergy of £21m

It may be possible to reduce costs for the regional press industry by as much as 12% in Anglia

- Despite the rural nature of and large size of the Anglia region the proximity of existing printing operations for the six major groups means that there is some ability to extract printing cost synergies.
- Similarly there are likely to be significant cost savings that can be extracted from regional overheads, management and advertising sales.
- Note that these forecasts are very much estimated figures and do not result from an in-depth analysis of likely consolidation benefits.

Source: Company Accounts, Oliver & Ohlbaum Analysis
In the North West the cost savings that might be achieved through a merger of the major regional press groups could equate to 11% of all costs

- The proximity of all key metropolitan centres in the region (Manchester, Liverpool, Preston & Leyland) could allow some printing operation synergies
- However, some groups already exploit printing synergies between them through joint operation of the Trafford Presses and so the overall benefit would be limited
- Note that these forecasts are very much estimated figures and do not result from an in-depth analysis of likely consolidation benefits

Source: Company Accounts, Oliver & Ohlbaum Analysis
**CAN CROSS-MEDIA SYNERGIES BE EXPLOITED?**

Summary – potential benefits of cross-media synergies

The synergies that could be exploited through cross-media mergers between local press groups and other local media are limited – newsgathering is only a small proportion of the total cost involved in running local TV services and radio stations.

Potential for and benefits of cross-media mergers in local markets

<table>
<thead>
<tr>
<th>COMBINATION</th>
<th>KEY POTENTIAL SYNERGIES</th>
<th>ISSUES</th>
<th>LIKELIHOOD OF MERGER</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RADIO + PRESS</strong></td>
<td>• Newsgathering synergies</td>
<td>• Most radio station news journalists also present the news on air so limited ability to cut costs in this area, if any</td>
<td>• LOW</td>
</tr>
<tr>
<td></td>
<td>• Ad sales synergies</td>
<td>• Few brands advertise on both radio and press and advertising sales methodology differs considerably for radio and press</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Overheads and management synergies</td>
<td>• Radio management roles are specific to radio functions and so limited scope to cut costs in this area</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Already scope for such mergers but very few in place to-date</td>
<td></td>
</tr>
<tr>
<td><strong>LOCAL TV + PRESS</strong></td>
<td>• Newsgathering synergies</td>
<td>• Significant newsgathering synergies can be exploited</td>
<td>• LOW</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• However, news only a small proportion of local TV channel costs</td>
<td></td>
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<td></td>
<td></td>
<td>• Limited spectrum and at best marginal economics for local TV channels - so few expected to launch</td>
<td></td>
</tr>
<tr>
<td><strong>ITV1 REGIONAL NEWS + PRESS</strong></td>
<td>• Newsgathering synergies</td>
<td>• Significant newsgathering synergies</td>
<td>• HIGH</td>
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<td></td>
<td></td>
<td>• Potential revenue upside from ITV1 airtime</td>
<td></td>
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<td></td>
<td></td>
<td>• However, 4-6 newspaper groups would need to co-ordinate in each ITV1 region</td>
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<td></td>
<td></td>
<td>• Significant fixed cost of running a TV production operation would remain</td>
<td></td>
</tr>
<tr>
<td><strong>ONLINE + PRESS</strong></td>
<td>• Newsgathering synergies</td>
<td>• Newspaper already own and operate their own online content and also classified portals</td>
<td>• LOW</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Regional press groups unlikely to find major synergies with large national vertical classified websites</td>
<td></td>
</tr>
</tbody>
</table>

Source: Oliver & Ohlbaum Analysis