



Independent National Radio licence extensions – Review of financial terms

Statement

Publication date:

4 July 2006

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Section 1

Introduction

- 1.1 Under the Communications Act 2003 Independent National Radio operators (Classic FM owned by GCap Media plc, talkSPORT owned by UTV plc and Virgin Radio owned by SMG plc) can apply for a four year extension period to their existing national radio licence. The licensees applied for this extension in April 2006.
- 1.2 Section 253 of the Communications Act 2003 requires Ofcom to determine revised financial terms for the Independent National Radio licences where they have applied for an extension. The terms determined by Ofcom for this purpose are detailed in Section 3 of this document.
- 1.3 The licensees have until 4 August 2006 to inform Ofcom that they wish to accept the terms. If accepted by the licensees, the revised terms will apply during the extended licence period as follows;
 - Classic FM - From 1 October 2007 - 30 September 2011
 - Virgin Radio - From 1 May 2008 – 30 April 2012
 - talkSPORT - From 1 January 2009 - 31 December 2012
- 1.4 The payments due in respect of these licences are collected by Ofcom and paid to the Consolidated Fund of HM Treasury.

Section 2

Background

- 2.1 Financial terms for the licences were originally set after a competitive tender process in the early 1990's. The terms were subsequently reviewed and determined, on a licence by licence basis, by the Radio Authority between 1999 and 2000.
- 2.2 When Ofcom assumed its powers on 29 December 2003 it inherited licence terms with differing timescales for review and revaluation.
- 2.3 Following a consultation published on 16 November 2005 which closed on 6 January 2006, Ofcom proposed a process that brought the review of financial terms for the licences together into a single unified process. Subsequently, on 14 February 2006, Ofcom published its methodology for licence valuation.
- 2.4 Following applications from the licensees for extensions to their licences, as required by the Act, Ofcom has determined a "Percentage of Qualifying Revenue" ("PQR") to be payable for each year of the licence and an amount that, in Ofcom's opinion, would have been the cash bid of the licence holder were the licence being granted afresh following an application made in accordance with section 98 of the Broadcasting Act 1990.

Key factors

- 2.5 In order to determine the outcome of a hypothetical auction, Ofcom has sought to estimate the net present value of an efficiently operated licence within the constraints imposed by the statutory framework.
- 2.6 As set out in its Statement, the aim of the process was to set terms that are reasonable within the context of the current market environment, and that so far as possible continue to be reasonable for the period of the licence extension. Ofcom has therefore taken into account a number of key developments in the broadcasting market and regulation. Two of the most significant developments are:
 - the growth in digital broadcasting; and
 - developments in the radio advertising market

1. The growth in digital broadcasting

- 2.7 Since 2000, when the Radio Authority reviewed the talkSPORT licence, listening on digital radio has grown from around zero¹ to 11.4%² of total radio listening. One million DAB receivers are estimated to have been sold in the five months to March 2006, bringing the cumulative total to 3 million³. Radio listening has also grown on other digital platforms, such as digital television and the internet. These trends appear likely to continue throughout the extended licence period, leading to a decline in the scarcity value of the analogue spectrum.

¹ Listening to digital radio has been measured since January 2003

² RAJAR Data Release 11 May 2006. Available at <http://www.rajar.co.uk/INDEX2.CFM?menuid=6>

³ DRDB News Release, 2 May 2006. Available at http://www.drdb.org/index.php?internalPage=arch_articles.php?s=2006-5-1&e=2006-5-31&internalHeaderPage=arch_articles_hd.html

- 2.8 Furthermore, as detailed in its recent publication, *Radio: Preparing for the Future: Phase 2*⁴, Ofcom has long recognised that AM stations are at a particular disadvantage in retaining listeners because of the relatively poor quality of the medium. Total hours of digital listening is growing such that it will shortly exceed total hours of AM listening. The financial terms take into account the migration of audience from analogue platforms to digital platforms to the extent that analogue listening is expected to be exceeded by digital listening by the end of the extended licence periods.

2. Developments in the radio advertising market

- 2.9 Since the existing financial terms were set, the national radio licence operators have faced various revenue pressures. The advertising recession and the growth of other forms of advertising media, particularly the internet, has meant that in real terms 2005 total radio advertising revenue was around 5% below levels seen in 2000⁵. Competition for national radio advertising revenue has intensified with new national and regional digital services, new analogue regional services and industry consolidation resulting in the re-enforcement of alternative national radio offerings. Whilst future radio advertising revenue is dependent on the wider macro economic outlook, the competitive pressures the national operators face, both from within and outside the industry are unlikely to abate. For the national analogue licences, the share of advertising derived as a result of access to the analogue spectrum is likely to fall.
- 2.10 Ofcom has taken account of these trends in its determination and has also used a number of sources (including the independent forecasts and industry estimates) to inform its view of overall advertising growth.

⁴ Available at http://www.ofcom.org.uk/consult/condocs/radio_reviewp2/p2.pdf

⁵ Advertising Association - Long Term Advertising Expenditure Forecast from 2005-2017

Section 3

Outcome

- 3.1 Licence payments consist of both an annual cash sum (which increases in line with inflation) and a PQR which is applied to advertising and sponsorship revenue attributable to national analogue listening hours. The existing payment terms are shown in the table below:

Table 1 - Existing payment terms

	PQR	Cash sum (£'000s) payable in 2006	Current licence end date
Classic FM	14%	1,161	30 September 2007
talkSPORT	6%	563	31 December 2008
Virgin Radio	12%	1,125	30 April 2008

- 3.2 These terms will continue to apply until the current licence end date. The revised terms determined by Ofcom will, if accepted, apply for the extension period, being four years commencing from the current licence end date.
- 3.3 In setting the terms for Classic FM, Ofcom has sought to recover 95% of the value of the licence through PQR payments, subject to the constraint that the PQR should be set as an integer. The cash sum is set to recover the remaining value.
- 3.4 In the case of Virgin Radio and talkSPORT, future payments made by these licensees are expected to fall to such a level that for administrative convenience, Ofcom has determined that the payment should be collected solely through the cash sum, with the PQR being set to zero. A summary of the revised terms are presented in the table below.

Table 2 - Revised terms

	PQR	Cash sum (£'000s)	Licence extension end date
Classic FM	6%	50	30 September 2011
talkSPORT	0%	100	31 December 2012
Virgin Radio	0%	100	30 April 2012

- 3.5 The cash sum is subject to annual up rating in line with the RPI index.
- 3.6 Under the current terms, payments in the first year of the extended licence period would be expected to total around £7m. If licensees accept the revised terms offered this morning, Ofcom estimates that total payments in the first year of the extended licences would be less than £1.5m.