COMPETITION COMMISSION

ERICSSON/CREATIVE MERGER INQUIRY

Summary of hearing with Macquarie held on Wednesday 6 November 2013

Background

1. The Macquarie Group (Macquarie) is a full service investment bank and is listed on the Australian stock exchange. Macquarie Infrastructure and Real Assets (MIRA) is a stand-alone division operated separately from the rest of the Macquarie Group.

2. MIRA manages around £30 billion worth of equity, raised from third party investors in infrastructure, real estate and private equity funds, which is invested in around 110 businesses globally. [✂].

3. Macquarie owns about 24 per cent of the equity in Red Bee Media (RBM) via its investment in a fund called Macquarie Advanced Investment Partners (MAIP), which is the owner of RBM.

The decision to acquire BBC Broadcast

4. In 2005, the BBC was privatising an entity called BBC Broadcast. Macquarie put together a consortium, led by a fund called Macquarie Capital Alliance Group (MCAG), which was listed on the Australian stock exchange. MCAG had raised AUS$1 billion and was mandated to invest in private equity assets globally. Macquarie was the other consortium member and provided about 35 per cent of the equity. The consortium acquired BBC Broadcast for about £190 million. BBC Broadcast was subsequently renamed as Red Bee Media.

5. [✂].

6. BBC Broadcast offered a blue chip customer base, stable cash flows and contracted revenues until December 2015. As a former public sector asset that had been privatised, MIRA also believed that the opportunity existed to reduce costs.

7. In 2006, Macquarie sold around six per cent of its stake in RBM. In 2008, new investors wanted the MCAG assets unlisted and MCAG was taken private through an acquisition by MAIP. Following the acquisition, MAIP held (and still holds) around 94 per cent of RBM with six per cent held privately.

The financial performance of RBM and capital structure

8. Macquarie said that it had purchased RBM with expectation of revenue growth. It had successfully decreased the reliance on revenue from the BBC contracts, [✂].

9. MIRA believed that for the MCAG investors who bought in 2005 and sold in 2008, RBM had performed well and had broadly achieved the business plan assumptions around revenue and EBITDA growth. [✂].

10. [✂].

11. MIRA said that its involvement in RBM consisted of seats on the RBM board and an observational or information gathering role where MIRA employees spent time with the CFO etc. Through its board members, Macquarie would see business plans and

budgets and had approval rights over investments when they were brought to the board. [✂] investment decisions were considered as to whether a project would provide an acceptable return given the amount of risk involved.

The decision to sell RBM and the sale process

12. MIRA had looked to sell RBM in May 2011. By mid-2012, the sale had not advanced and Rothschild was appointed to look at the available options and act as a potential refinancing adviser. Rothschild found that RBM's debt was [✂] and thought the financial markets would see this as being at the high end of the spectrum in today's financial markets, in the context of a leveraged buyout or private equity deal.

13. Rothschild believed that banks would not want to take on this level of debt when coupled with the risk that RBM's large playout contracts might not be renewed. Rothschild concluded that refinancing could only be achieved via a large injection of equity.

14. This was not an option for the MAIP fund, which was was put together with the express purpose of acquiring MCAG and did not have any surplus capital for new investments - the fund was due to be wound up in June 2013. Putting new money into RBM was not feasible and the only viable option was to sell RBM.

15. [✂].

16. JP Morgan was Macquarie's sell-side adviser and approached over 60 bidders - 40 strategic buyers and 20 financial sponsors. There were about eight approaches from potential purchasers. Six were of a more formal basis [✂].

17. Two informal approaches were also received [✂].

18. Deloitte (restructuring/refinancing adviser), and Berwin Leighton Paisner (legal advisers) were appointed at the start of 2013 to look at options with regard to lenders. The first half of 2013 year was spent looking at options with senior and junior lenders, who were keen that RBM was sold.

19. MIRA confirmed that there was an earlier approach by Ericsson in 2010. In October 2011 an initial expression of interest was received from [✂]. A further offer was received in 2013 [✂] and at one point an offer [✂] was received for the media distribution business only.

20. Following the [✂] bid from Ericsson in 2013, JP Morgan advised that though the figure was still not enough, it was reaching a position where the liabilities could be paid, which was the bare minimum needed to complete a deal. Macquarie also spoke with the lenders as to whether they would do a deal at a lower price and [✂] the lenders said no.

21. [✂].

22. MIRA recognised that the acquisition was likely to be looked at by the competition authorities and the SPA contained conditionality that recognised the risk of referral. The Ericsson deal would clear RBM's liabilities (by the expected close date in February 2014) and the lenders had reluctantly agreed to extend the debt facilities to facilitate the deal.

23. At the proposed sale price, both the senior and junior debt would be repaid. [✂]. Both are syndicated debt facilities held by third party institutions. There was an inter-

company loan from CBSI, but as part of the transaction this was effectively waived and no longer exists.

24. [✂].

25. MIRA viewed RBM as a successful business and believed an important factor in the reluctance of buyers was that they would not take a risk on the contract renewals. [✂]. With these constraints, it was challenging to achieve a purchase price that would repay the value of the liabilities, which Ericsson had agreed to pay. As a trade buyer, it was hypothesised that Ericsson was potentially in a better position to take a risk on the contract renewals than a private equity buyer or a financial sponsor.

The competitive environment

26. MIRA said that RBM operated in a very competitive market. Buyers were powerful and the significant price reduction following the BBC Access Services contract renewal was a big blow for RBM. MIRA said that for the BBC Access Services contract, it believed none of the other competitors had the infrastructure and experience offered by RBM, and hence there would be significant risk in the BBC choosing an alternative supplier. Nonetheless in this circumstance the BBC was able to achieve about a [✂] price reduction, demonstrating the BBC's power.

27. MIRA said playout technology was developing at a rapid pace, and there was a move away from large, bespoke equipment into more IP-based, playout-in–a-box, and remote playout options. This meant that it was getting cheaper and easier to obtain a service that was previously quite bespoke. MIRA believed the BBC was considering adopting a new and broader approach to the procurement of its playout services, incorporating a broader suite of services, and which would include traditional technology outsourcing companies as possible providers.

28. [✂].

29. MIRA believed that RBM was a strong company, but was unsure as to how strong a competitor it was in the playout market. MIRA saw RBM as an attractive business as it saw it as providing a fantastic service and was unique in the way it could offer customers a combination of Creative, Access and Media Distribution Services . It delivered demanding service level agreements (SLAs) to customers and went beyond the call of duty to ensure that these were met. Unfortunately, this did not translate into maintaining high margin contracts.

30. RBM provided cross-revenue opportunities and synergies with its creative output. Macquarie had seen the benefit of this with the Access services it provided in Australia, where the subtitling business had provided playout opportunities.

31. MIRA identified Arqiva as another potential playout provider, noting a vested interest having acquired it in late 2004. Arqiva is a bigger business than RBM. Both companies employed a similar number of people, but the scale of revenue and business activities were completely different. Playout revenues comprised less than one per cent of Arqiva’s total revenues. Within the playout market, historically RBM’s focus was on BBC and ITV, whereas Arqiva looked more to the smaller channels on BSkyB.

32. MIRA said the technology businesses of RBM and Arqiva were operating in difficult economic markets [✂]. Management teams were under pressure to find new ways of making money and were expanding into areas in which they previously had no or less presence. For RBM, this meant finding a way to operate more cheaply and

deliver more cost-effective services to a broader range of customers. Within the playout sector, Arqiva looked to expand and reach new customers and it had been a strong competitor for the recent BT Sport playout contract.

33. MIRA said Arqiva was unique in broadcasting as the sole provider of a TV network access and managed transmission services. It had excellent relationships with large broadcasters and was used to delivering extremely high SLA requirements, possibly more stringently than RBM. In the future, it was possible that Arqiva could become a more forceful competitor to RBM.

34. MIRA did not see Arqiva as a possible purchaser of RBM in the event that the deal with Ericsson fell through. The investor base in Arqiva was infrastructure focused, not private equity, which was what RBM offered in the financial world. RBM would not be viewed as a strategic acquisition or a place to put capital and the risk-adjusted return would not be seen as sufficient.

Outsourcing

35. MIRA believed that as both the BBC and ITV used to run their playout services in-house, there was no reason why each could not do this again. The decision to outsource was taken as it made sense at the time and it was purely a matter of what was the most cost effective option. Both BSkyB and Discovery currently operated playout services in-house.