Terms of reference and conduct of inquiry

Terms of reference

1. On 12 July 2011, the OFT sent the following reference to the CC:

   1. In exercise of its duty under section 22(1) of the Enterprise Act 2002 (the Act) to make a reference to the Competition Commission (the CC) in relation to a completed merger, the Office of Fair Trading (the OFT) believes that it is or may be the case that—

      (a) a relevant merger situation has been created in that:

         (i) enterprises carried on by or under the control of Kerry Foods Limited have ceased to be distinct from enterprises carried on by or under the control of Headland Foods Limited; and

         (ii) as a result, the conditions specified in section 23(4) of the Act will prevail, or will prevail to a greater extent, with respect to the manufacturing and supply of frozen ready meals in the United Kingdom; and

      (b) the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the UK for goods or services, including the manufacturing and supply of frozen ready meals.

   2. Therefore, in exercise of its duty under section 22(1) of the Act, the OFT hereby refers to the CC, for investigation and report within a period ending on 26 December 2011, on the following questions in accordance with section 35(1) of the Act—

      (a) whether a relevant merger situation has been created; and

      (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the UK for goods and services.

   3. In relation to the question whether a relevant merger situation has been created, the CC shall exclude from consideration one of the subsections (1) and (2) of section 23 of the Act if they find that the other is satisfied.

   (signed) AMELIA FLETCHER
   Senior Director and Chief Economist
   Office of Fair Trading
   12 July 2011

Conduct of inquiry

2. On 13 July 2011 we posted on our website an invitation to express views about the merger. On 27 July 2011 we posted an administrative timetable for our inquiry. On 3 August 2011, we posted an issues statement on our website.

3. We invited selected competitors and customers of the two companies to comment and fill out a questionnaire on the merger. We gathered oral evidence through hearings with selected third parties. Summaries of these hearings are on our website.

4. Two members of the Inquiry Group, accompanied by staff, visited the Kerry FRM manufacturing facility located in Grimsby, which was acquired from Headland.

5. We received written evidence from Kerry and posted a non-confidential version on our website.

6. During the course of our inquiry, we sent Kerry some working papers for comment.

7. We published a non-confidential version of our provisional findings on 25 October 2011. Non-confidential versions of responses to our provisional findings were also posted on our website.

8. Our final report was published on 2 December 2011 and also posted on our website.

9. We would like to thank all those that have assisted with our inquiry.

Interim measures

10. On 12 July 2011, we adopted the initial undertakings accepted by the OFT from Kerry on 25 March 2011. These undertakings are on our website.

11. On 11 August 2011, we directed Kerry to appoint a monitoring trustee in order to prevent any pre-emptive action by Kerry which might prejudice the outcome of the reference or impede the CC from taking remedial action if it were to reach an SLC decision. These directions are also on our website.

The counterfactual

Introduction

1. This appendix sets out our evidence and assessment on the counterfactual. The counterfactual is the likely situation in the absence of the merger, against which the effects of the merger are compared.

Exiting firm scenario

2. Kerry submitted to us that Headland was a failing firm and that therefore the appropriate counterfactual against which to assess the merger was not the state of competition before the merger but Headland's inevitable exit from the market shortly after the date of the merger.

3. We examine this submission following the Guidelines which sets out three points to consider:

   (a) whether the firm would have exited (through failure or otherwise); and if so

   (b) whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration; and

   (c) what would have happened to the sales of the firm in the event of its exit.

4. If we do not believe that the firm would have exited, then we do not necessarily need to look at parts *(b)* and *(c)*. However, as the majority of the Headland shareholders were private equity investment firms, for whom an exit is ultimately required so that funds can be returned to their investors, we consider, in the absence of the merger, whether the Headland shareholders would have sought offers from alternative buyers.

Would Headland have exited?

5. The Guidelines state that, in the context of a firm exiting for reasons of financial failure, consideration is given both to whether the firm is unable to meet its financial obligations in the near future and to whether it is unable to restructure itself successfully.

Meeting financial obligations

6. Kerry submitted that Headland was heavily loss-making, having consistently made losses, including very substantial operating losses, since 2006.

7. We reviewed Headland's financial accounts for the five years 2006 to 2010, which showed that Headland had made losses after interest in each of these years. It made operating losses in [✂] out of the five years and a small operating profit in [✂]. Table 1 summarizes Headland's financial performance.

TABLE 1 **Summary of Headland's financial performance, 2006 to 2010**

£'000

	2006	*2007*	*2008*	*2009/10**	*2010*†
Turnover	58,815	63,928	74,510	88,908	[✂]
Operating profit/loss	**–1,426**	**–197**	**–825**	**74**	[✂]
Impairments/amortization	–628	–9,411	0	–5,510	[✂]
Net interest payable	–2,341	–2,246	–2,493	–2,844	[✂]
Profit/loss after interest	–4,395	–11,854	–3,318	–8,280	[✂]

Source: Headland annual report and financial statements.

*15 months to 27 March 2010.
†Nine months to 31 December 2010 (management accounts).

8. Headland's financial performance was poor. It had been loss-making since 2006 with very large losses in 2007 and 2009/10, although we note that the bottom-line losses in these two years appear to be driven, in part, by adjustments to Headland's balance sheet (impairment of goodwill in 2007 and impairment of fixed assets in 2009/10, the latter which arose due to an impairment review being carried out as a result of the sale of the business to Kerry).

9. We examined the financial performance from Headland's management accounts which showed more detail. Table 2 shows Headland's actual financial performance for the five years to 2010 and budgeted figures for 2011. We understand that the figures for 2011 include *(a)* the price rise requested from customers which was subsequently not accepted, and *(b)* the lost business relating to the Tesco contract which was subsequently lost, but exclude potential new business relating to the [✂] contract [✂] (see paragraph 14). This means that it is hard to determine the true picture for 2011.

10. Headland made an operating loss in [✂] of the six years shown, and only a small operating profit in the other [✂] years. Sales volumes (by tonnage and by number of meals) declined from a high in 2008. Turnover followed the same trend, with a slight rise in 2011 in total turnover and turnover per meal (although note the word of caution above). Prime costs (comprising raw materials and direct labour) are high and rising relative to turnover, and the gross margin has fallen over the six-year period, to [✂] per cent. Two-thirds of overheads are fixed, which means that only a small decrease in volume has a relatively large effect on operating profit. Once overheads are taken into account, operating profit is maximum [✂]p per meal. Thus, for Headland to achieve profits with such a high level of prime costs and overheads, it is essential to have volume.

TABLE 2 **Headland six-year site profit and loss**

	Actual 2006	*Actual 2007*	*Actual 2008*	*Actual 2009*	*Actual 2010*	*Budget 2011*
Sales volume ('000 tonnes)	35,979	38,754	42,675	40,630	[✂]	[✂]
Sales volume ('000 meals)	78,434	84,506	93,032	88,573	[✂]	[✂]
Turnover (£'000)	58,308	63,078	74,051	71,387	[✂]	[✂]
per meal (£)	*0.74*	*0.75*	*0.80*	*0.81*	[✂]	[✂]
Prime costs (£'000)	40,688	44,246	53,562	51,388	[✂]	[✂]
per meal (£)	*0.52*	*0.52*	*0.58*	*0.58*	[✂]	[✂]
Gross margin (£'000)	17,620	18,832	20,489	19,999	[✂]	[✂]
Gross margin (%)	*30.2*	*29.9*	*27.7*	*28.0*	[✂]	[✂]
Overheads—variable (£'000)	5,030	4,747	6,945	5,708	[✂]	[✂]
Contribution to fixed costs (£'000)	12,590	14,085	13,544	14,291	[✂]	[✂]
per meal (£)	*0.16*	*0.17*	*0.15*	*0.16*	[✂]	[✂]
Overheads—fixed (£'000)	12,942	13,524	14,347	14,060	[✂]	[✂]
per meal (£)	*0.17*	*0.16*	*0.15*	*0.16*	[✂]	[✂]
Operating profit/ loss(£'000)	–352	561	– 803	231	[✂]	[✂]
per meal (£)	*0.00*	*0.01*	*–0.01*	*0.00*	[✂]	[✂]

Source: Headland management accounts summary provided by Kerry (2006–2010); Headland management accounts (2011).

Note: Prime costs include raw materials and direct labour; 2011 overheads split between fixed and variable on basis of 2010.

Headland's trading in 2010

11. In 2010 Headland lost substantial sales business. The former Managing Director of Headland told us that there was a significant raw material cost increase in the first half of 2010 relating to costs of chicken imported from Thailand and cooked beef imported from South America. Once these costs had stabilized in June 2010, Headland requested price increases from its customers of [✂] per cent (chicken) and [✂] per cent (beef), in order to maintain its profit margins. Whilst negotiating these price rises with customers, Headland was informed [✂] that it would lose its own-label FRM business with Tesco (with revenues of approximately £[✂] million) which it had agreed to switch to Kerry in response to more competitive pricing. We understand (from Tesco) that the loss of the Tesco contract was also due to other factors including [✂]. The former Finance Director of Headland told us that Tesco told Headland that the reason it lost the contract was mainly due to price; that Tesco sometimes raised concerns about [✂]. Headland was also in negotiations with [✂] to maintain its supplier contract with revenues of approximately £[✂] million.

12. Despite the substantial sales lost, Headland also won new FRM business in 2010 such that the combined revenues of Headland's new contracts in 2010 were higher than the combined revenues of its lost contracts. The former Managing Director of Headland told us that Headland won new FRM business with [✂], [✂] and [✂]. At the time of the sale, Headland was also in discussions with [✂] to manufacture a range of its products under a contract packing arrangement, and was [✂] (worth approximately £[✂] million a year) with [✂] to supply [✂] previously supplied by Kerry.

13. Kerry claimed, however, that any increase in turnover was entirely consistent with a worsening of its financial position, as these volumes were gained at unsustainably low prices; and that Headland was unable to win any significant new business that was commercially sustainable.

14. We put these assertions to Chamonix. It told us that, [✂]. The former Finance Director of Headland told us that the [✂] margins on the [✂] were justified because the products were 'the jewel in the crown' of [✂]: they were well-established products with large sales volumes and long production runs (which meant less downtime on the production line due to changeover between products).

15. For other contracts ([✂]), Chamonix acknowledged that it was difficult for Headland to pass on cost increases in line with input price increases to preserve Headland's profit margin. It stated that limited price increases might have been achieved, but that it was likely that these would not have been sufficient to recover the full anticipated raw materials cost increases. Further losses would also have been incurred by Headland due to the time lag between the increases in raw materials costs and the customers accepting a price increase. However, Chamonix believed that, with the implementation of the restructuring, Headland would be likely to return to profitability in the short term.

16. We also looked at Kerry's financial performance at the Carrickmacross site, which is shown in Table 3. Performance (in terms of sales volumes, turnover, and turnover per meal) had [✂] between 2006 and 2010, with turnover in 2006 and 2010 of €[✂] million and €[✂] million respectively. Although gross margin had been broadly maintained at approximately [✂] per cent, much [✂] than Headland's margin of [✂] per cent, operating profit (pre-currency hedge) had [✂]. This appeared to be due to high fixed operating costs ([✂]). As with Headland, it appears that high volumes are required to achieve profits.

TABLE 3 **Carrickmacross five-year site profit and loss**

	Actual 2006	*Actual 2007*	*Actual 2008*	*Actual 2009*	*Actual 2010*
Sales volume ('000 meals)	[✂]	[✂]	[✂]	[✂]	[✂]
Turnover (£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
per meal (£)	[✂]	[✂]	[✂]	[✂]	[✂]
Prime costs (£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
per meal (£)	[✂]	[✂]	[✂]	[✂]	[✂]
Gross margin (£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
Gross margin (%)	[✂]	[✂]	[✂]	[✂]	[✂]
Overheads—variable(£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
Contribution to fixed costs (£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
per meal (£)	[✂]	[✂]	[✂]	[✂]	[✂]
Overheads—fixed(£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
per meal (£)	[✂]	[✂]	[✂]	[✂]	[✂]
Operating profit/loss* (£'000)	[✂]	[✂]	[✂]	[✂]	[✂]
per meal (£)	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Kerry.

*Pre-currency hedge.
Note: Prime costs include raw materials and direct labour.

Financial obligations and cash flows

17. Because a firm is loss-making, it does not necessarily mean that it will exit the market, but it may do so if it is unable to repay its debts as they fall due.

18. The Guidelines state that consideration is given to whether a firm is unable to meet its financial obligations in the near future, and that we should examine the firm's balance sheet to determine the profile of assets and liabilities.

19. Headland's balance sheet is summarized in Table 4. It shows that, due to its continued losses, its net asset value was negative and worsening from 2007. The accounts show that all its long-term debt was held by its shareholders rather than by a bank or a major creditor.

TABLE 4 **Headland's capital and reserves, 2006 to March 2010**

	2006	*2007*	*2008*	*2009/10**
Called up share capital	2,719	2,719	2,719	2,719
P&L reserve	–1,382	–12,633	–15,226	–25,171
Total shareholders' funds	1,337	–9,914	–12,507	–22,452

Source: Headland annual report and financial statements.

*15 months to 27 March 2010.

20. Capital expenditure at Grimsby and Flint had been limited to repair and maintenance costs (ie no expenditure on new items) with the exception of a Raque line[1] installed in 2008 costing (including expenditure on modifications to the existing manufacturing facility) approximately £[✂] million.

Liquidity

21. Liquidity is a measure of a business's ability to meet its payment obligations, in terms of possessing sufficient liquid assets. The current ratio is current assets divided by current liabilities, a measure of whether a business has enough resources to pay its debts over the next 12 months. A ratio of below 1 means that the business may have problems meeting its short-term obligations. The quick ratio (or acid test) is current assets less inventory divided by current liabilities, meant to be a measure of a business's ability to use its near cash (or quick assets) to extinguish its current liabilities immediately. A company with a quick ratio of less than 1 cannot currently pay back its current liabilities.

22. Headland's liquidity ratios are set out in Table 5. The table shows a sudden increase in current liabilities in 2009/10, and hence a worsening of liquidity ratios for this period. This was, however, caused by a reclassification of shareholder loans as being payable within one year rather than after one year due to the sale of Headland's business in January 2011 and as such, an adjustment needs to be made. Making the adjustment to reclassify the shareholder loans as being payable after more than one year (which would have been the case had the sale to Kerry not taken place) is shown in the last column.

TABLE 5 **Headland's liquidity ratios, 2006 to 2010**

	2006	*2007*	*2008*	*2009/10**	*2009/10* (adjusted)*
Current assets (£'000)	15,507	16,682	17,412	15,299	15,299
Current liabilities (£'000)	11,992	12,567	14,175	50,869	12,319
Current ratio*	1.3	1.3	1.2	0.3	1.2
Current assets less inventory (£'000)	9,815	9,677	9,729	9,055	9,055
Quick ratio	0.8	0.8	0.7	0.2	0.8

Source: Headland annual report and financial statements; CC analysis.

*15 months to 27 March 2010.

23. The current ratios (for 2009/10, the adjusted ratios) set out in Table 5 show that Headland was solvent over the period that Headland was making losses. The current ratios are higher than would normally be expected from a firm suffering a severe liquidity shortage. The quick ratios show that Headland would have had trouble paying back its liabilities without support from its creditors.

[1] High speed ready meal production line. Raque Food Systems is a US manufacturer of production lines.

24. We looked at the debt position as at 14 January 2011. Creditors totalled £[✂] million, of which £[✂] million was debt held by the shareholders (£[✂] million secured and £[✂] million unsecured junior debt). These are large amounts of debt to support on such low operating profits. We understand that interest on the secured and junior debt was not actually paid, but instead rolled up into the principal amounts.

25. Headland's liquidity position was poor. It is possible that Chamonix and the other shareholders could have withdrawn their support for the business at any time by calling in their shareholder loans. If they had done this, Headland would have gone into liquidation or receivership.

Responding to Kerry's view on Headland's financial obligations

26. Kerry submitted that, without support from Chamonix, Headland could not have survived for any length of time: it was already in a position of having to pay a number of its key suppliers in advance, had to agree to a charge against its Grimsby factory to pay wages, and had to pay a deposit to secure its electricity supply.

27. We put this submission to Chamonix. It told us that, although loss-making, Headland still had sufficient cash/funding facilities to continue trading for the foreseeable future and sufficient cash/funding facilities to complete the restructuring plan (see below).

Restructuring successfully

28. The second leg of the examination of a firm exiting for reasons of financial failure is whether a firm is unable to restructure itself successfully. The Guidelines state that we should consider the action the management has taken to address the firm's position and review contemporaneous documents such as board minutes, management accounts and strategic plans.

29. Headland shareholders and management had been considering various options for returning Headland to profitability. A strategic review was carried out with the assistance of external advisers, which started in early 2009 and continued into 2010. Two main options considered were *(a)* closure of the Flint factory and introducing branded products; and *(b)* a combination with Kerry's FRM business. Other options considered were combination with another operator, and a strategic change to the business (involving product rationalization and customer diversification). This was Chamonix's and Headland's first joint attempt to restructure Headland.

30. Following the strategic review, and prior to, and concurrently with, the sale discussions with Kerry, Chamonix and the other Headland shareholders prepared plans to improve Headland's business. This was a separate exercise from the sale discussions with Kerry and, if completed in full, would have involved a combination of:

    (a) the physical reorganization of operations to a single factory at Grimsby and the closure of the factory at Flint (the Consolidation Plan);

    (b) a balance sheet restructuring to improve the credit position of the business and improve working capital/trading terms (the Financial Restructuring Plan); and

    (c) a change in trading strategy to seek to move the business away from lower-quality, high-volume and low-margin retail/brand customers and towards higher-quality and higher-margin business with, for example, airlines, food service, and/or European mainland, customers (the change in strategy, which we examine separately to the restructuring plans).

31. Other options, such as Headland acquiring Kerry's FRM business, a joint venture between Headland and Kerry, and a combination with the FRM business of [✂], did not prove fruitful and were not pursued in any depth.

The consolidation plan

32. Headland decided to consolidate its business by closing the Flint factory and moving all production to its remaining factory in Grimsby. This was to take costs out of the business by reducing the overhead at Flint, and to remove excess capacity following the loss of the Tesco contract.

33. A Headland document sets out the consolidation plan in detail. The loss of the Tesco contract reduced the volumes at both factories to too low a level of capacity, of [✂] per cent. At this level of output the two factory overheads, which had a large fixed element, became unsustainable: the forecast operating loss, based on a two-site operation, was £[✂] million for the year to March 2011, and £[✂] million for 2011/12. The Headland management team was confident that the business could be consolidated successfully on to the Grimsby site with the reduced level of business. The consolidation started prior to the sale to Kerry and was scheduled to complete during the first half of 2011.

34. Following the consolidation, operating profits to March 2012 were forecast to be £[✂] million (an improvement of £[✂] million). We understand from the former Managing Director that this improvement was in fact a conservative figure: the intention was to reduce overheads at the Grimsby factory further once the consolidation had taken place. Reorganization costs of £[✂] million were due to be funded by cash, the current banking facility, and the planned improvement in creditors following the proposed balance sheet reorganization (see paragraph 35ff), which were split £[✂] million redundancy and disruption costs and £[✂] million capital expenditure.

The financial restructuring plan

35. Chamonix and Headland's other shareholders (who held all the secured and junior debt) also prepared a financial restructuring plan for Headland. One document acknowledged the need to restructure Headland financially due to a combination of changes in the business apparent since 2008, including the effects of food inflation on the business, perceived high levels of debt, a balance sheet that showed the business to be technically insolvent, and a complete lack of credit insurance for the business from credit insurers. The document stated that these factors had placed considerable pressure on Headland's working capital.

36. The financial restructuring plan involved a recapitalization of Headland's balance sheet in order to reduce its indebtedness. Specifically, a debt/equity swap was to be carried out which would have written off junior and shareholder debts totalling £[✂] million, resulting in total shareholder funds of £[✂] million (compared with the 2009 balance sheet showing negative shareholder funds of £22.5 million).

37. The benefits of the restructuring were set out to be numerous: improvement of trade credit; return of the electricity deposit (see paragraph 26); improvement of availability of bank funding required to complete the consolidation plan; reduction in concerns from key customers as to the financial viability of the business; reduction in operating costs; reinstatement of credit insurance. The improvement in the cash position was estimated to be between £[✂] million and £[✂] million.

38. In the event, although a lot of preparatory work was done, the restructuring was not carried out, because of the sale to Kerry. However, Chamonix told us that if the sale had not occurred, it would have pressed on with the financial restructuring.

Responding to Kerry's view on Headland's restructuring plans

39. Kerry submitted that these restructuring plans were poorly considered and unrealistic: the plans *(a)* had scarcely gone beyond the first step of the redundancies consultation process; *(b)* had not adequately dealt with any of the numerous technical and logistical issues (for example, it had not been confirmed that Iceland, whose products were at the time produced as boil in the bag at Flint, would wish them to be produced in trays); and *(c)* grossly underestimated the costs of the restructuring. It told us that the relocation and closure was highly unlikely to have succeeded without further investment.

40. We put these assertions to Chamonix. It acknowledged that significant risk existed in senior management being able to deliver the consolidation plan to time and to budget. However, the plan had been considered for two years, at a step by step level, and had gone into a lot of detail with regard to minimizing disruption to the business. Headland had recently recruited senior management for the specific purpose of implementing the consolidation plan, including a Manufacturing Director with experience of restructuring operations. The plan was formally signed off in November 2010 (by which point Headland was already in talks with Kerry) and the 90-day consultation process with the employees at the Flint factory commenced very shortly thereafter. The plan did not go beyond the first steps of the redundancy consultation process because of the sale to Kerry, but Chamonix confirmed to us that it was confident the plan would work. We considered that, had the sale to Kerry not gone ahead, Headland management would have made more concrete progress with regard to the detailed logistics of transferring, building, trialling and layout of equipment at the Grimsby factory, during and immediately after the statutory consultation period. Chamonix also told us that it was confident it had estimated the costs correctly: in any event, nearly half the costs related to redundancy which were known in great detail. It also told us that it had oral agreement from Iceland that it would accept FRM packaged in trays in place of boil in the bag, and that the cost and logistics of transferring the lines from Flint to Grimsby in order to meet Iceland's FRM requirements was planned for, and included in the £[✂] million capital expenditure. This was confirmed to us by Iceland. Iceland also told us that there would have been an increase in cost from moving from boil in the bag to tray packaging, which was all to be offset by the cost efficiencies achieved by the move, specifically *(a)* cost savings relating to operating from one site, and *(b)* the factory filled with simple long production runs of large-volume products.

41. Corroborating Chamonix's view, the former Finance Director of Headland also told us that the management team was reasonably confident that it could manage the closure of Flint and the move to Grimsby.

42. Chamonix also confirmed that, in its opinion, there was sufficient cash and financing to carry out the plans: it told us that it understood that Headland's management were confident that both the site consolidation plan and the balance sheet restructuring could be completed with Headland's own resources (primarily from a receivables financing facility plus residual cash reserves). Chamonix acknowledged that there was a risk that the actual cash flow of Headland might not have been sufficient to pay entirely for the cost of the restructuring plans, and as a consequence, further funding from the Headland shareholders may have been necessary to complete the plans, but that this was understood.

43. Chamonix also told us that it did not envisage there being any material risks in implementing the financial restructuring.

44. Kerry also said that Headland would in fact have begun, even in 2011, to make losses, because of *(a)* irrecoverable raw materials cost increases, *(b)* additional consolidation costs, and *(c)* substantial loss of business. We disagreed: we noted *(a)* (as already mentioned in paragraph 14) that just before the merger was announced [✂]; *(b)* that Chamonix was confident that it had estimated costs correctly; and *(c)* that the Headland management and shareholders were confident that the move to Grimsby could be carried out successfully.

Chamonix's expectations following the restructuring plans

45. Chamonix told us that if both the consolidation plan and the financial restructuring plan had been carried out, the expectation was that Headland would have returned to at least breakeven and more likely to earn an EBITDA (earnings before interest, tax, depreciation and amortization) of up to £[✂] million a year. However, Chamonix's expectation was for the forecast breakeven position, and any actual improvement in the profitability of Headland, to be difficult to sustain beyond the short term (ie over the subsequent two- to three-year period) owing to anticipated continued cost inflation and continued pressure on prices from its core retail/brand customers.

46. Chamonix told us that, in order to maintain Headland's trading volumes with the existing customer base at the time of the sale to Kerry, it was expected that Headland would have had to continue to manufacture and supply FRMs to retail/brand customers at high volume and low prices, in order to compete against the other manufacturers and suppliers of FRMs to retail/brand customers. It anticipated that this would have resulted in an ongoing erosion of Headland's profit margins. However, Chamonix expected that the restructuring plans would have enabled Headland to remain as effective a competitor as it had been in 2010, but would not have enabled Headland to improve its competitive position in view of the forecast difficulty of sustaining a break-even/more profitable position beyond a two- to three-year period.

47. Kerry said that Headland had a poor track record in budgeting, and that in all but one of the five periods to December 2010 had overestimated its likely performance by between £[✂] million and £[✂] million (there was only a very small difference between actual and budget in the period to March 2010). We looked at the reasons for the differences between budgeted and actual profits and found that there were good reasons for these differences, and decided that we had no reason to doubt the accuracy of Headland's projections following the restructuring plans. We noted that the main difference in both 2006 and 2007 was due to exceptional items (which by their nature could not be budgeted for); that the £[✂] million difference in 2008 was due to raw materials cost increases; and that the main difference in the period to December 2010 was due to a sales price increase which Headland was unable to push through (see paragraph 11). In response to our provisional findings report, Kerry argued that failing to recover in respect of cost increases provided evidence in support of the proposition that Headland was likely to have been overly optimistic in its projections. We disagreed: we noted that the raw materials cost increases in 2008 were difficult to predict.

The change in strategy

48. Kerry submitted that Headland would have withdrawn from head-to-head competition with Kerry in the supply of high-volume low-value FRM to the major supermarkets, to

focus on airline meals and other non-core FRM business; and that there was no evidence to sustain the proposition that Headland would have continued in effective competition with Kerry in the supply of FRM to supermarkets in even the medium term.

49. Chamonix's intention was also to explore further opportunities to diversify the trading activity of Headland away from retail/brand customers. For example, it planned to expand further the supply of FRM to airline and food service customers, and to this end it had already recruited senior management in both these areas. Chamonix also expected to explore further whether Headland should specialize in the supply of certain product groups (eg pasta meals) and expand this service both to new sectors and new territories (eg EU mainland customers).

50. Chamonix told us that this expansion, however, required substantial further investigation before it could be considered a feasible alternative strategy for Headland, and that in the interim, Chamonix's expectation was that the core activity of Headland was to have remained the manufacture and supply of FRM including to FRM and retail/brand customers.

51. Kerry also submitted that if Headland had survived for more than several months, it would have tried to obtain price increases and/or bid at higher prices going forward; Headland's previous strategy of going for turnover growth by means of lowering prices to unsustainable levels would have failed, leaving no alternative but to raise prices (the 'flailing firm' argument).

52. We do not believe this to be the case. First, consolidating business on to one site would have decreased overheads, resulting in less pressure on margins, possibly enabling Headland to price more competitively. The prices Headland submitted in response to the [✂]. Secondly, the former Finance Director of Headland told us that Headland was a price taker and would have found it difficult to increase prices; Chamonix told us that Headland would not have been able to increase prices sufficiently or quickly enough to recover all cost increases, that the market demanded a low-price strategy from all participants, and that the reason Headland lost the Tesco contract was because it tried to increase prices.

Chamonix's exit

53. Kerry submitted that there was no credible evidence that any other purchaser was interested in purchasing Headland, and no evidence at all that any other purchaser was interested in operating it as an FRM business.

54. We understand that the sale to Kerry was as a result of an opportunistic bid and not as a result of a comprehensive and formal sale process during which other potential purchasers were contacted, although it should be noted that the strategy review conducted by Headland did not identify any other potential purchasers who were thought capable of acquiring or likely to acquire Headland.

55. Looking into the future, Chamonix told us that, provided the restructuring plans enabled Headland to return to breakeven (or better), a further attempt to identify alternative buyers for Headland might also have been made. However, whilst Chamonix and the other shareholders of Headland would have been considering the most profitable time to sell Headland, in the absence of the sale to Kerry, no formal decision or plan had been put in place.

Closeness of competition between Kerry and Headland

Introduction

1. In this appendix, we set out the analysis we have done to assess the closeness of competition between Kerry and Headland in the supply of FRM pre-merger.

2. We analysed tender data for FRM contracts to assess the extent to which customers switched FRM supply between Kerry and Headland pre-merger, and reviewed qualitative submissions from customers and competitors to consider the extent to which the parties were close alternatives.

3. In the first section of the appendix, we focus on the qualitative evidence received with regards to the length of tenders and their frequency. We look at the preference of customers to maintain existing supply relationships, and finally the extent of competition between Kerry and Headland.

4. In the second section, we provide information on the shares of supply of FRM held by Kerry and Headland. We look at the shares of all FRM and then the shares of own-label FRM and contract pack FRM supply separately. We considered only the shares of FRM supply as Headland did not produce CRM.

5. In the supply of all FRM, Kerry and Headland had a combined share of approximately [50–60] per cent of retail volume and [40–50] per cent of value. The parties had a [50–60] per cent value share of own-label FRM supply, and a share of [over 80] per cent of contract pack FRM supply, indicating that they were, by some margin, the largest FRM suppliers.

6. In the final section, we analyse the tender data submitted by Kerry and customers. We calculated the share of contracts in terms of number, volume and value that switched between Kerry and Headland and the share of contracts which were retained. We calculated this for tenders for all products and tenders for low end-value products. Where possible, we also looked at the rankings of the tenders.

The tender process

Frequency of tenders

7. We collected details of the tendering process from third parties, including seven supermarkets and three contract pack customers. In this section, we provide a summary of the relationships between these parties and the different tender structures. It is only retailers that tender for the supply of own-label FRM. Contract-packed FRM are also tendered but from the perspective of retailers these are treated as branded FRM.

8. The length of contracts varies across customers. For example, one retailer told us that it operated four-month rolling contracts, whereas another said that it was in a two-year contract. A summary of customers' typical/existing contract lengths is shown in Table 1.

TABLE 1 **Existing/typical contract lengths for FRM customers**

Customer	*Contract length*
Asda	[✂]
Birds Eye	[✂]
Co-op	[✂]
Iceland	[✂]
Sainsbury's	[✂]
Tesco	[✂]
Lidl	[✂]
Findus	[✂]
Marlow Foods	[✂]
Morrisons	[✂]

Source: Customer responses to OFT questionnaire, third party hearings.

9. We found that the relationships with contract pack customers are more formal than with retail customers. One told us that there would always be a formal contract once the final supplier was decided. Another customer told us that it was always written into contracts at what stage price changes would be discussed.

10. In general, products tend to be put out to tender relatively infrequently, with the preferred method being to negotiate with a supplier during the course of a contract. Several customers told us of the importance of establishing successful relationships with suppliers, which we describe in more detail below.

11. Birds Eye told us that a tender was conducted in 2004 where business was spread between Kerry, Headland and Vion Foods, and since 2006 the majority of its business had been with Kerry and Headland. It conducted a tender of its FRM business in September and October 2010 with the aim of moving all of its products to one supplier.

12. [✂]

13. [✂] told us that the last tender it conducted was in [✂], and that this was the only tender that [✂] had conducted in the last five years. Another retailer told us that while fixed contracts were sometimes given, in the majority of cases there would not be an end contract date, and that it would be an ongoing contract until the range of products was reviewed.

14. [A retailer] told us that it generally conducted tenders on an ad hoc basis [✂]. [Another retailer] told us that generally it would conduct tenders twice a year for a summer and winter refresh of its products.

Preference for incumbent supplier

15. A customer told us that while aiming to negotiate the best price possible, it had a preference for maintaining existing suppliers where possible, because there was always a cost to moving business. Birds Eye told us that as it put so much emphasis on getting the right quality and working with the right co-packer, it generally did not change supplier very often. Birds Eye also told us that it gave feedback to all tendering parties.

16. Sainsbury's showed us a series of emails that it had exchanged with Kerry during the course of the tender for Sainsbury's own-label FRM in 2010, where Kerry was the current supplier of a number of the products up for tender. Sainsbury's provided Kerry with feedback on its bids relative to other bids (only from Headland), including the percentage by which the Kerry offer was higher for certain products. We do not know if similar emails were sent to other suppliers, but this showed the willingness of

Sainsbury's to give as much information as possible to at least the incumbent supplier.

17. Iceland told us that rather than tendering products among a range of suppliers and pitching against each another, it had a preference for long-term loyalty. One customer also told us that it tried to establish a long-term relationship with contract packers, as moving products was difficult due to the required development time and investments.

18. [✂] told us that it had developed a close relationship with Headland and would simply [✂]. Ferndale Foods, a manufacturer of FRM for Waitrose, told us that it had been supplying Waitrose since 2001.

19. Asda told us that tenders were ongoing, but it had a preference for joint business plans, and that if it had a good relationship with a supplier it would enter into annual negotiations for restructuring the FRM range, quality and prices. Asda also told us that instances of switching supplier for like-for-like products were very rare, and that when it had occurred it had been initiated by an approach from another supplier.

20. Asda also told us that it liked to maintain relationships as both customer and supplier would learn how their respective businesses worked and what they needed, and it took time to build up this knowledge.

21. While customers expressed the benefits of maintaining relationships with a supplier, we were also told that there were costs to switching supplier. We obtained limited evidence on the magnitude of these costs but we present what is available below.

22. A retailer told us that it had switched [✂] at a cost of approximately £[✂] per line. The costs included new artwork and packaging, a factory audit and production run tests, transport costs and management and technologist's time for product development.

23. A retailer stated that switching costs related to development, packaging and mark-down costs and were approximately £[✂] per line, but subsequently clarified that these costs were incorporated into the cost price offered to the retailer by the supplier. Lidl told us that any costs were borne by the supplier.

24. Among other customers, the common sources of costs were new artwork, product development, management time and reconfiguring technology and equipment.

Extent of competition between Kerry and Headland

25. Kerry and Headland were suppliers able to offer a comprehensive range, covering the full range of own-label FRM required by large retail chains and contract pack FRM required by brand owners. Other competitors on the whole were not able to provide such a complete offer.

26. When speaking about whom it invited to tenders, Birds Eye told us that its top two suppliers would have been Kerry and Headland and that the other suppliers capable of supplying Birds Eye's entire suite of FRM products had much less capacity.

27. [✂] expressed similar views to Birds Eye. It told us that it would generally only deal with category one suppliers and that only Kerry and Headland were in this category. It added that other than Kerry and Headland, it might not trade with suppliers due to these suppliers not being able to deliver cost efficiencies and maintain technical standards.

28. Morrisons told us that at the value tier of products only Kerry and Headland were capable of producing the volumes required, and that only with mid-tier products, where the complexity began to increase, could smaller suppliers be considered.

29. Morrisons also said that during 2010 Headland sought a price increase and as a result it decided to switch to Kerry, as Kerry was a relatively small supplier for it at that time. Kerry was approached as it had spare capacity at its Carrickmacross factory, whereas another supplier to Morrisons, [✂], was not approached as it would have been unable to cope with the volume. Morrisons also stated that the parties were closest competitors in the value range of FRM while there would be more competition for mid-tier products because smaller suppliers such as [✂] could also make competitive offers for such FRM.

30. Lidl told us that, [✂] that Headland and Kerry produced for it, [✂]. In fact, it told us expressly that Kerry and Headland would be particularly close competitors for Lidl [✂].

31. Findus has [✂] production lines at a plant called South Quay Meals which produce FRM fish and potato gratins and FRM fish pies (all others were previously sourced from Headland), [✂]. Findus also told us that currently [✂].

32. Co-op told us that aside from Kerry [✂]. Co-op also told us that in light of the merger and the proposed cost increases by Kerry, there would not be ‘an automatic number two or number three supplier that can offer the full range of frozen ready meals that it can turn to as an alternative’.

33. Co-op added that if it wanted to replace each line individually it would be likely to have to go to more than one supplier, which would take time to determine capability and capacity of new suppliers. Co-op presented [✂] as an example of a supplier with whom it would like to extend its range, but said that there was no capacity for extra business until [✂].

34. [✂] told us that in October 2010 it looked at [✂] as alternative suppliers. [✂] did not meet [✂] technical standards and [✂] did not want to supply low-tier FRM, and was expensive for mid-tier FRM. Therefore it was left with Kerry and Headland as the only viable alternatives pre-merger.

35. [✂] told us that post-merger, no supplier other than Kerry supplied or had the ability to supply FRM at low end price points. This was reinforced by the fact that following recent price increases, [✂] had had no choice but to continue to stock Kerry products, as there was now no direct alternative. Kerry provided us with an email from [✂] which it said showed that [✂] had found possible alternative suppliers; in response to this, Kerry [✂].

36. [✂] It added that MDC could compete with Kerry in terms of capability and efficiency for some products but suffered from having a longer supply chain and currency risks.

37. Suppliers other than Kerry and Headland also commented on the extent to which they competed with Kerry and Headland in the supply of FRM. Authentic, for example, told us that it [✂].

38. Food Pro told us that it competed with a range of FRM suppliers and included the following as competitors: Kerry Foods, Loxtons, Kershaws, Country Park, Summit Foods, Authentic Foods, S & A Foods, Strathmore Foods, Laila’s Fine Foods, Danby’s, KK Foods, Pinguin, Northern, Heinz, Bakkavor and Cook. Food Pro said

that this list was not exhaustive. It also told us that over the last five years it had had product lines it had shared with Kerry and Headland.

39. Heinz, a manufacturer of its own range of FRM under the 'Weight Watchers from Heinz' and 'Ross' brands, told us that [✂]. Moreover, Heinz stated that [✂].

Multi-sourcing and importance of customer in terms of capacity utilization

40. Some customers told us that the ability to switch supply could be used to keep control on the prices of existing suppliers. Iceland told us that volume was very important to Headland, and that there was always an inherent threat of moving volume to Kerry if Headland had sought unjustifiable price rises. Whilst not as explicit as Iceland, Asda told us that it had suppliers presenting offers on a regular basis, and that while the incumbent would have had an opportunity to maintain business, the new offers would be used as an internal benchmark to shape negotiations.

41. Sainsbury's told us that [✂], suggesting that Sainsbury's was able and willing to switch between Kerry and Headland. It told us that Headland had the minority of the range but it was a supplier that could have manufactured the Kerry range, and that historically Kerry had been chosen due to lower cost price.

42. From the supplier side, [✂] told us that in its experience retailers would be keen to use the tendering process as 'a stick to beat current suppliers with and get a better price', and that generally, unless there was a big problem, customers would look to retain the incumbent and get a better deal.

43. A retailer said that it was important to maximize volume with a particular supplier in order to get the best terms. It would choose one supplier which could produce all of the range rather than splitting the volume over several suppliers.

44. We looked at the share of supply of Kerry and Headland for own-label and contract-pack customers in 2010. Table 2 shows the total retail value of FRM for each customer, and the share of value that was supplied by Kerry, Headland and other suppliers.

TABLE 2 **Kerry and Headland share of supply for own-label and contract-pack customers, 2010**

Customer	*Total FRM retail value £m*	*Kerry %*	*Headland %*	*Other %*
[✂]	[✂]	31	21	48
[✂]	[✂]	29	42	29
[✂]	[✂]	0	100	0
[✂]	[✂]	13	78	9
[✂]	[✂]	100	0	0
[✂]	[✂]	0	83	17
[✂]	[✂]	93	0	8
[✂]	[✂]	1	46	53
[✂]	[✂]	68	26	6
[✂]	[✂]	0	55	45
Total	[✂]	[✂]	[✂]	[✂]

Source: Kerry, [✂] and [✂].

Note: [✂] values based on supplier volumes March 2010 to February 2011.

45. Table 2 shows that for any given customer, Kerry and Headland did not have equal supply shares. The most similar shares of supply were for [✂], where Kerry had a [20–30] per cent share and Headland had a [40–50] per cent share. The high supply shares of Kerry and Headland are in line with the submissions saying that Kerry and Headland had the ability to supply the high-volume own-label products.

Shares of supply in FRM

46. Table 3 shows estimates of the retail share of supply of all FRM in 2010. Kerry and Headland were the largest suppliers, with approximately double the share of the third largest supplier Heinz, which is not currently a competitor to Kerry and Headland for the supply of own-label or contract-packed FRM. Kerry and Headland had a combined share of approximately [50–60] per cent in terms of the number of units supplied and [40–50] per cent in terms of value.

TABLE 3 **Shares of UK total FRM supply, 2010**

Supplier	*Units m*	*Share %*	*Value £m*	*Share %*
Kerry	[✂]	20–30	[✂]	20–30
Headland	[✂]	20–30	[✂]	20–30
Heinz	[✂]	10–20	[✂]	10–20
Youngs	[✂]	<10	[✂]	<10
Authentic Foods	[✂]	<10	[✂]	<10
Loxton Foods	[✂]	<10	[✂]	<10
Food Pro	[✂]	<10	[✂]	<10
Kershaws	[✂]	<10	[✂]	<10
Others	[✂]	10–20	[✂]	20–30
Total	[✂]	100	[✂]	100

Source: Kerry/Nielsen estimates.

47. Tables 4 and 5 show the shares of supply of own-label and contract-packed FRM. The share of supply is reported in value terms for 2010. Looking at own-label FRM supply in Table 4, Kerry and Headland again had a significantly larger share than any other supplier, with Headland having the largest. Kerry had a share of [20–30] per cent compared with Headland's [30–40] per cent share.

TABLE 4 **Shares of UK own-label FRM supply, 2010**

Supplier	*Value £m*	*Share %*
Kerry	[✂]	20–30
Headland	[✂]	30–40
Authentic Foods	[✂]	<10
Loxton Foods	[✂]	<10
Food Pro	[✂]	<10
Crops	[✂]	<10
Stratmore Foods	[✂]	<10
Lailas Fine Food	[✂]	<10
Others	[✂]	10–20
Total	[✂]	100

Source: Kerry/Nielsen estimates.

48. Table 5 shows that in 2010 there were only three suppliers of contract-packed FRM: Kerry, Headland and Longbenton. Longbenton went into administration in March 2011 and subsequently exited the market. Kerry had the largest share of contract-packed supply with approximately [50–60] per cent share with Headland also having a large share with approximately [30–40] per cent. It is noticeable that the total sales of contract-packed FRM, £[✂] million, was considerably smaller than the sales of own-label FRM (£[✂] million).

TABLE 5 **Shares of UK contract-packed FRM supply, 2010**

Supplier	*Value £m*	*Share %*
Kerry	[✂]	50–60
Headland	[✂]	30–40
Longbenton	[✂]	<10
Total	[✂]	100.0

Source: Kerry/Nielsen estimates.

Note: Longbenton entered administration on 11 March 2011.

49. These tables show that Kerry and Headland were the largest two suppliers for the supply of own-label and contract-packed FRM.

Tender data

50. We received details of previous tenders from a number of large retailers and the three largest contract-pack customers. The information requested included the products and the volumes of the products up for tender, the unit price for each product that was bid for by all parties submitting bids, and the winner of each tender. We did not receive enough detailed tender data to be able to conduct any complex analysis.

51. We have also used data submitted by Kerry on the tenders of which Kerry and Headland were part from 2005 to 2011. This data included the customer name, the number and value of the units the tender was for, the incumbent supplier of the products and the winner of the tender.

52. Kerry told us that the data had limitations: it might not cover all the tenders in which it participated (staff compiled it from memory), and would not include tenders in which neither Kerry nor Headland participated. However, we have been told that for low-value own-label FRM, Headland and Kerry were the only viable competitors, and as all own-label FRMs were tendered, we were satisfied that we had covered this segment. We could not be as confident for mid-range own-label products as in principle there could have been tenders which did not include Kerry or Headland, but given that we received data from large retailers and contract-pack customers, we expect the data set to be reasonably comprehensive. Retailers also explained that they had to assemble the information from email exchanges and the memory of buyers.

53. Where possible, we updated the data submitted by Kerry using information submitted by third parties.

54. Tables 6 to 8 do not reflect the decision by Birds Eye to tender its FRM business in late 2010, as no switching took place. Birds Eye had approximately £[✂] million of business with Kerry for the financial year beginning 1 April 2010 which if included would have had a significant effect on the value and volume share of contracts which switched between Kerry and Headland.

55. The switching and retention figures in Tables 6 and 7 include a tender from Asda in 2006 where its entire range of FRM was put up for tender. This tender was worth approximately €[✂] million, and was retained by Kerry. Given that this one tender accounted for approximately [✂] per cent of the total value of all tenders in the data set, it may distort the results. Notably it accounts for a substantial part of the business retained by Kerry ([✂] per cent of volume and value). In Table 8 we report the results excluding this tender.

56. Table 6 shows the number, volume and value of contracts which switched between Kerry and Headland and were retained by each of the parties. The contract for the entire Asda range in 2006 is shown separately to give an indication of its relative size. It should also be noted that in Tables 6 to 8 the total number of contracts, total volume and total value figures is also shown for new contracts, contracts which switched between and were retained by other suppliers and contracts which switched from other suppliers to either Kerry or Headland.

TABLE 6 **Number, volume and value of contracts retained and switched between Kerry and Headland**

	No of contracts	*Contract volume*	*Contract value €*	*Share of contracts %*	*Share of tendered volume %*	*Share of tendered value %*
Kerry to Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Headland to Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Retained by Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Retained by Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kerry to Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Headland to Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Other—switch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Other—retain	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
New contract	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Asda 2006—retained by Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	145	380,298,033	373,194,676	100	100	100

Source: CC analysis of Headland and Kerry tender data submitted to the OFT.

Note: [✂] Large Asda contract in 2006 is not included in the calculation of the main switching/retention figures. This contract is shown separately.

57. In terms of both value and volume, only [less than 15] per cent of the contracts in the data set switched between the parties. The proportion of volume and value which was retained by the parties is significantly larger, with a combined [50–70] per cent of volume and [60–80] per cent of value. Retention by Kerry accounted for the majority of this. Kerry retained [40–60] per cent of its contract volume and [40–60] per cent of its contract value.

58. In Table 7, we show the number, value and volume of contracts for low-value-end products which switched between the parties and was retained. We defined low-value-end product tenders as those where the average unit cost of the products up for tender was less than 90c per unit.

TABLE 7 **Number, volume and value of contracts retained and switched between Kerry and Headland for low-value-end products**

	No of contracts	*Contract volume*	*Contract value €*	*Share of contracts %*	*Share of tendered volume %*	*Share of tendered value %*
Kerry to Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Headland to Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Retained by Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Retained by Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kerry to Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Headland to Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Other—switch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Other—retain	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
New contract	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Headland and Kerry tender data submitted to the OFT.

Note: [✂].

59. As in Table 6, the share of volume and value that was retained by Kerry was high, but slightly lower than the total sample of products at [40–60] per cent for both. The large Asda contract of 2006 is not classified as low-value end and is not included in the calculations. The share of contracts which switched between Kerry and Headland was again comparatively low, at only [less than 20] per cent in terms of volume and [less than 20] per cent in terms of value, a slight increase on the total sample. The main difference for the low-value-end products compared with the total sample was that a lower share of contracts switched from Kerry to other suppliers and Headland retained a greater share of its contracts. The share of contracts that Headland retained increased from [0–20] to [20–40] per cent by volume and [0–20] to [20–40] per cent by value.

60. This evidence is in line with submissions from customers that they preferred to maintain relationships with suppliers where possible. It also supports customer comments that Kerry and Headland were particularly important suppliers for low-value FRM. However, it is possible that the retention figures are overstated as we are unable to tell in the Kerry data whether a contract had been tendered, ie there had been competition from two or more suppliers, or whether it was just a continuation of a contract with a supplier and there has been no competition.

61. To illustrate the importance of the Asda 2006 contract, Table 8 shows the number, value and volume of contracts which switched between the parties and was retained excluding this contract.

TABLE 8 **Number, volume and value of contracts retained and switched between Kerry and Headland**

	No of contracts	*Contract volume*	*Contract value €*	*Share of contracts %*	*Share of tendered volume %*	*Share of tendered value %*
Kerry to Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Headland to Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Retained by Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Retained by Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kerry to Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Headland to Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Kerry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Headland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Other—switch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other to Other—retain	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
New contract	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Headland and Kerry tender data submitted to the OFT.

Note: [✂] Large Asda contract in 2006 is not included in the calculation of the main switching/retention figures.

62. [Less than 20] per cent of the contracts by value ([less than 20] per cent by volume) switched between the parties, solely made up of switching from Headland to Kerry. The proportion of contracts which were retained by Kerry and Headland was still very high. [60–80] per cent of contracts by value (increasing to [60–80] per cent by volume) were retained by either Kerry or Headland.

63. There was no systematic record of the rankings of suppliers in the tender data submitted to the OFT. Using further tender data submitted by customers of Kerry and Headland, we identified the winner and runner-up in the tenders for 25 contracts. In 11 of these contracts Kerry was the runner-up to Headland, in nine contracts Headland was the runner-up to Kerry, and in the remaining five contracts Headland was the winner with a supplier other than Kerry finishing as runner-up.

64. In ten of the contracts where we could establish the rankings of the bidders there was a third bidder, and in the remaining 15 contracts there were only two bidders, 11 of which had Kerry and Headland as the only bidders. Six of these 15 contracts were for [✂] where the third place firm was [✂] which, as mentioned in paragraph 34, was considered expensive for mid-range FRM. [✂] was the third placed supplier in three contracts for [✂], and [✂] was the third placed supplier for one [✂] contract.

The constraint from CRM

1. This appendix sets out the information we obtained from Kerry, its competitors and customers regarding the substitutability of FRM by CRM, and our assessment of this evidence.

Competitors

2. Kerry said that manufacturers of CRM could switch to the production of FRM relatively quickly and at relatively low cost (supply-side substitution), essentially by adding a spiral freezer which in its view could be purchased for around £0.8 million, requiring around 16 weeks to install. [✂][1,2] Moreover, Kerry told us that the logistics of CRM supply would be more complex than those for FRM.[3]

3. Ferndale, a supplier mainly active in CRM, told us that it would be interested in supplying FRM, but that availability of an FRM facility would be crucial for such entry and that Flint, the only available FRM site it was aware of, would be unavailable due to the Kerry/Headland merger. [✂], another CRM supplier, said that it currently had no plans to enter into the supply of FRM. This was in line with retailers' experience that CRM manufacturers would not be interested in supplying FRM.[4] For example, one customer told us that it had tentatively discussed creating a new supply chain with a CRM supplier. This customer found that this prospective new supplier had little interest in entering into FRM because the profitability in the FRM sector would not be as lucrative as chilled, and the market was declining. Birds Eye also noted that it would not expect CRM suppliers to enter the FRM market because they would need to buy new production equipment, especially freezers, and because the organization of the production process was fairly different (compared with FRM, CRM production required more frequent manufacturing of small batches to ensure timely delivery within their shelf life, while FRM lines had much longer production runs and were highly automated). The evidence therefore suggested to us that supply-side substitution from CRM into FRM such as to offer a meaningful competitive constraint appears to be unlikely.

Customers

4. As explained above, retailers switching from FRM to CRM in response to an increase in the relative price of FRM and CRM would also imply a constraint from CRM on FRM and would increase retailers' buyer power vis-à-vis Kerry.

5. With respect to such demand-side switching, Kerry said that customers of large retailers very often bought both types of ready meal when they shopped.[5] We noted that customers are likely to shop for a variety of otherwise unrelated goods (for example, they may buy toothpaste and household detergent whenever they buy ready meals. This observation would not imply that ready meals and toothpaste (or detergent) are substitutable from the perspective of either the retailer or the end customer).

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[1] See Kerry's initial submission, paragraph 11.
[2] [✂]
[3] Kerry's initial submission, paragraph 12.
[4] Regarding entering from FRM into CRM, Heinz, for example, told us that [✂]. Authentic, a manufacturer of own-label FRM, told us that [✂].
[5] Kerry's initial submission, paragraph 10.

6. Kerry also said that retailers' decisions on space allocation in store were long-term decisions. This is not consistent with the argument that FRM and CRM are substitutes. If FRM and CRM were demand-side substitutes, retailers would flex their space allocation more often to accommodate their customers' switching between FRM and CRM.

7. Most retailers explained that they would not consider CRM to be a substitute for FRM in any meaningful sense due to a perceived quality and freshness difference and a resulting price differential. CRM cost and retail prices are higher than those of FRM and CRM would therefore attract a different profile of customers than FRM. Co-op said that, in its experience, switching would be more likely between the premium end of FRM and CRM. Co-op also told us that it would therefore not generally switch from FRM to CRM even if there were a wholesale price rise of between [✂] and [✂] per cent in FRM products. Sainsbury's said that, in its experience, consumer switching from FRM to CRM (in response to Kerry's recent cost price rises) had been very low. There would therefore be insufficient demand to allow Sainsbury's to switch FRM volume to CRM. Marks & Spencer also told us that FRM would currently be a very separate segment of its business and that the likelihood that it would switch between FRM and CRM would be very small.

8. Kerry said that the price differential between value-end CRM and FRM would often not be large. Table 1 shows evidence Kerry provided in support of this point, together with the percentage difference of CRM and FRM prices relative to FRM prices (per gram).

9. As the table shows, the retail prices of CRM per gram are lower than those for FRM bought individually, but are generally higher than those for FRM sold in multi-buys. Exceptions to this are Morrisons' lasagne, where the FRM is still slightly more expensive than the CRM (per gram) even in a multi-buy, and Morrison's spaghetti bolognese, where the CRM and FRM prices per gram are equal.

10. It is also worth noting that the price per gram for individual FRM and CRM are equal for Tesco's chicken curry, and that the FRM price per gram for its lasagne is lower than the price for CRM if the alternative value FRM mentioned in Kerry's notes to the table is taken into account.

TABLE 1 **Differences in prices between CRM and FRM**

Retailer	*Meal*	*CRM/FRM Price p*	*CRM/FRM Weight g*	*CRM/FRM Price per g ppg*	*FRM Promotion*	*FRM Promotion ppg*
Asda	Chicken curry	74/130	300/400	0.25/0.33	5 for £4	0.2
Asda	Cottage pie	84/130	300/400	0.28/0.33	5 for £4	0.2
Asda	Lasagne	71/130	300/400	0.24/0.33	5 for £4	0.2
Asda	Spaghetti bolognese	74/130	300/400	0.25/0.33	5 for £4	0.2
Tesco	Chicken curry	74/130*	300/400	0.25/0.33	5 for £4	0.2
Tesco	Cottage pie	84/130	300/400	0.28/0.33	5 for £4	0.2
Tesco	Lasagne	71/75†	300/400	0.24/0.33	5 for £4	0.2
Tesco	Spaghetti bolognese	74/130	300/400	0.25/0.33	5 for £4	0.2
Sainsbury's	*Chicken curry*	*N/A/130‡*	*N/A/400*	*N/A/0.33*	*4 for £3*	*0.19*
Sainsbury's	Cottage pie	84/130	300/400	0.28/0.33	4 for £3	0.19
Sainsbury's	Lasagne	74/130	300/400	0.25/0.33	4 for £3	0.19
Sainsbury's	Spaghetti bolognese	74/130	300/400	0.25/0.33	4 for £3	0.19
Iceland	*Chicken curry*	*N/A/100*	*N/A/500*	*N/A/0.2*	*N/A*	*N/A*
Iceland	*Cottage pie*	*N/A/100*	*N/A/500*	*N/A/0.2*	*N/A*	*N/A*
Iceland	*Lasagne*	*N/A/100*	*N/A/500*	*N/A/0.2*	*N/A*	*N/A*
Iceland	*Spaghetti bolognese*	*N/A/100*	*N/A/500*	*N/A/0.2*	*N/A*	*N/A*
Morrisons	*Chicken curry*	*N/A/130§*	*N/A/400*	*N/A/0.33*	*3 for £3*	*0.25*
Morrisons	Cottage pie	84/130	300/400	0.28/0.33	3 for £3	0.25
Morrisons	Lasagne	70/130¶	300/400	0.23/0.33	3 for £3	0.25
Morrisons	Spaghetti bolognese	74/130	300/400	0.25/0.33	3 for £3	0.25
Co-op	Chicken curry	89/120	300/400	0.30/0.3	3 for £3	0.25
Co-op	Cottage pie	89/120	300/400	0.30/0.3	3 for £3	0.25
Co-op	Lasagne	89/120	300/400	0.30/0.3	3 for £3	0.25
Co-op	Spaghetti bolognese	89/120	300/400	0.30/0.3	3 for £3	0.25

Source: Kerry's initial submission, Annex B.
(Kerry evidence based on Asda, Tesco & J Sainsbury websites accessed by Kerry on 29 July 2011; Iceland, Asda and Co-op figures observed in-store by Kerry on 1 August 2011.)

*There is a further value FRM available at 74p for 300g (0.25ppg).
†There is a further value FRM available at 75p for 340g (0.22ppg).
‡There is a further value FRM available at 84p for 340g (0.25ppg).
§There is a further value FRM available at 66p for 300g (0.22ppg).
¶There is a further value FRM available at 85p for 300g (0.28ppg).
Note: N/A = not available.

11. Table 2, provided by Sainsbury's, illustrates the price differential between CRM and comparable FRM. This table contrasts with the evidence submitted by Kerry since it shows that there is a difference in the retail price of at least 44 per cent for comparable CRM and FRM.

TABLE 2 **Comparison of retail prices for CRM and comparable FRM—Sainsbury's**

CRM	*CRM price £*	*FRM price £*	*Difference %*
Lasagne 400g	2.00	1.30	54
Macaroni cheese 400g	2.10	1.30	62
Spaghetti bolgnese 400g	2.10	1.30	62
Cottage pie	2.10	1.30	62
Chicken dinner	3.25	2.00	63
Beef dinner	3.25	2.00	63
Battered sweet 'n' sour chicken and rice 400g	3.39	1.80	88
Chicken korma and rice 500g*	3.50	1.80	94
Chicken tikka masala 500g*	3.50	1.80	94
Beef stew and dumplings 450g	2.60	1.80	44

Source: Sainsbury's.

*FRM weight is 400g. Pro-rated CRM retail price: £2.80, that is a 56 per cent difference.

12. Four retailers said that end-customers were unlikely to switch from FRM to CRM in response to a retail price increase of 5 to 10 per cent. Three retailers said that some

end-customers would be likely to trade down in FRM or even stop buying FRM.[6] However, two retailers said that some customers might switch. (Iceland added that they would need to switch by buying at a different retailer, since Iceland sold only frozen foods.) Morrisons said that end-customers would switch if the price difference was smaller.

13. Birds Eye said that it expected end-customers to move more into CRM in the event of a price increase in FRM, since CRM were more expensive than FRM and an increase in the prices of FRM relative to CRM would narrow the price difference between the two. [✂], a supplier of CRM, said that there would be limited overlap between CRM and FRM due to higher prices for CRM. Ferndale's response also suggested that there was little switching between FRM and CRM. Northern Foods said that FRM and CRM would be substitutes for end-consumers, with FRM having a lower price than CRM.

[6] Only [✂] and [✂] mentioned that end-customers might stop buying in response to such a price increase.

Direct effects of the merger

1. In this appendix we consider whether there is direct evidence that Kerry was able, post merger, to worsen aspects of its FRM offer by raising prices above levels related to changes in input costs.

Direct effects of the merger on price

2. We looked at whether Kerry had been able to raise its net prices (ie prices net of input costs) after the merger. If this were the case it would be direct evidence of a unilateral effect, though if there were no such effect, it would not necessarily be strong evidence of no unilateral effects of the merger because it may be due to Kerry adjusting its behaviour to ongoing regulatory scrutiny.[1]

3. Kerry sought price rises after the merger. First, we summarize the views of Kerry and third parties on these price changes (see paragraphs 5 to 13). Next we analyse whether in practice Kerry imposed price rises in excess of raw material cost increases following the merger (paragraphs 14 to 63). We then consider evidence of whether Kerry could use any enhanced market position to change non-price aspects of its offer (see paragraphs 65 to 67).

Parties' views

4. This section summarizes the views of Kerry and its customers about the post-merger price changes.

Kerry

5. The Director of Meal Solutions at Kerry Group said that immediately after the merger (late January/early February 2011), Kerry sought to increase prices over and above what it had previously sought in relation to its pre-merger products, and over and above the pre-merger Headland prices arrived at in the course of its 'ill-starred' attempts to seek volume by reducing prices.

6. He said that Kerry had achieved price rises, but those rises (in so far as the super-markets were not able to reduce them or effectively to reduce them by delaying implementation) had, since February 2011, been all but entirely eroded by raw material cost increases that Kerry had been unable to pass on.

7. The Director of Meal Solutions at Kerry Group said that since the acquisition, Kerry had attempted to achieve two things through price increases: first, to keep pace with raw material cost increases; and second, to keep prices on a sustainable level going forward. Kerry said that it told all its customers immediately after the acquisition that FRM manufacture was in crisis and that prices had become unsustainable. At that time, the combined business was projected to make annual losses of [✂] per cent.

[1] Kerry said that it was theoretical speculation that it might have adjusted its behaviour due to ongoing regulatory scrutiny, indeed if it had attempted this it would hardly have attempted to increase prices. We noted this. We also noted that when it told customers it was seeking price rises after the merger, the OFT's investigation had not commenced. However, our conclusions on the statutory questions do not turn on this point.

8. In January/February 2011, just after the merger, a percentage increase was proposed for each customer. This increase was calculated by setting prices—broken down by customer and value tier—to give a profit margin of [✂] per cent on their forecast raw material costs. He said that this strategy met with only partial success and the benefit of the increases actually obtained had been overtaken by raw material cost increases, not least as the intention to put through increases in February was almost entirely unsuccessful in that retailers forced Kerry to delay implementation.

9. The Director of Meal Solutions at Kerry Group said that the vast majority (around [✂] per cent) of the price increase actually obtained had been overtaken by the increase in raw material costs. In short, he said that the benefit of the price increases obtained immediately after the acquisition had since been all but wiped out by soaring raw material costs, and Kerry had not felt able to approach customers seeking further price increases.

Customers

10. Customers, including both own-label and contract-packed customers, said that Kerry had sought significant price rises after the transaction. In addition to price rises across the board, some customers highlighted the importance of value range products, an issue we note here as we take account of them in our analysis. Sainsbury's considered that Kerry and Headland had provided competitively priced products at the bottom end of the retail price range, ie 75p to £1.50 per meal pre-merger; some other customers considered that the products at £1 to £1.30 retail price were those most affected by the merger. In line with these comments, Iceland considered that the merger had taken away any choice for 'full service' high-speed FRM manufacture, which was dominated by low value products. Therefore, we tested in our analysis whether value FRM are particularly affected by the merger.

11. As shown in Table 1 of our findings, the actual price increases Kerry achieved post-merger varied across customers. The price rises achieved were generally considerably larger than those requested by either Kerry or Headland pre-merger. The exception to this was the price increase proposed before the merger to Tesco by Headland, but Headland's proposed price rise [✂]. [✂] told us that Kerry had said the price increase was needed because of 'massive amounts of inflation' (of input cost). Iceland said that it had incurred significant price increases following the merger which it did not believe would have been imposed if the merger had not taken place.

12. Birds Eye said that, in January 2011, after the merger, Kerry had said that it might not accept the prices [✂] and said that it had not bought 'Headland Foods Limited' (as a company) but only bought the assets of the company. Therefore, [✂] with Headland would not bind Kerry. Later, Kerry presented Birds Eye with new pricing—ie different from that which Kerry had proposed less than one month earlier in December 2010 as part of the tender in which it had been unsuccessful—which increased the cost of the same products by £[✂] million. The new prices proposed post-merger were [✂] per cent higher than those Kerry proposed in December 2010 and [✂] per cent higher than Headland's. [✂]

13. With respect to these third party complaints and Kerry's explanation, we note that the rise in gross prices, in and of itself, may not be indicative of a merger effect, since rising input costs and seasonality could also drive price increases. Therefore, in the analysis that follows, we control for the input costs and seasonality to assess the post-merger price movements.

Kerry's prices

Methodology

14. Since the merger was completed in January 2011, the extent of any direct effect on price that may have already occurred can be analysed by comparing prices and charges before and after the transaction. Given that many price increases were implemented as late as June 2011 (and for a small number of FRM products even in August), we were only able to compare the price changes between July and August 2010 and 2011. The availability of only two months of data post-implementation of the price increases limited our analysis of direct price effects post-merger to some extent. We were therefore able to examine immediate price changes, but were not able to assess the extent to which price changes had persisted.

15. Factors unrelated to the merger might bias results. Such factors include input cost increases and seasonality, which might have contributed to price increases (Kerry suggested to its customers that the former had led to the need for price increases, see paragraph 7), and delisting and new product development which may, if not properly considered, lead to comparing the prices of different products (as FRM is an area characterized by new product development). To control for these factors, we compared the net prices of the same set of products in the same months in 2010 and 2011.

16. Net price was defined as the difference between gross price charged by Kerry and direct costs to produce a product (raw material cost, direct labour cost and other direct expenses; these are the unit production costs, also called 'prime cost').

17. We also compared the wholesale price changes and net price changes of FRM in 2010/11 to those of CRM in the same period.

18. We used a t-test to determine whether a price change was statistically different from zero. This test asks whether the mean of the unit prices of the individual overlap products in July to August in 2010 is equal to the mean of the unit prices of these same individual overlap products in July to August 2011 (and similarly for unit costs and net prices).[2] A low p-value suggests that the difference of the gross price, or unit cost, or net price in the two years is significantly different from zero. In other words, the gross price, unit cost and unit net price in 2011 are (statistically) significantly different from those in 2010. Moreover, a p-value smaller than 0.05 indicates that we can reject equality of these means in 2010 and 2011 at a level of confidence of 5 per cent (the level of confidence that is typically used in such statistical analyses). If this is the case, the difference of these means is said to be statistically significant (at a 5 per cent level of significance). If we can reject such equality at a lower level of significance, we can be more confident that this difference is in fact not zero and that the price increase is statistically different from zero.[3]

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[2] This t-test is identical to a regression of the unit prices (or unit costs, or net prices) in July–August 2010 and 2011 on a dummy for the year.

[3] With respect to the use of a t-test Kerry said that the calculation of p-values would be of questionable relevance. It observed that p-values of t-tests would be used only to market inferences about a wider population when only a sample was available. The second statement by Kerry is clearly correct. As Kerry itself appeared to suggest, the set of overlap FRM produced in July–August 2010 and 2011 could be interpreted as a sample for all products produced in those months, including those replaced due to range reviews by customers (ie including non-overlap FRM). Kerry suggested calculating the average for all FRM (overlap and non-overlap FRM) instead. However, calculation of the average net price increase for overlap and non-overlap products jointly as indication of the net price increase post-merger would be less telling since it might be true that only certain FRM, for example mainly expensive FRM, are delisted. In this case, the alternative average net price change for all FRM would understate the actual net price increase on FRM sold pre- and post-merger. Since Kerry's customers explained to us that delisting could be due to a number of factors and not all delisting had been due to the merger it is likely that the alternative net

The customers considered

19. We only considered customers for whose FRM business we knew when Kerry's post-merger price increase took effect: six retailers and three contract-pack customers. Three of those did not buy the same products in July/August 2010 and 2011. Therefore, we could not derive net price changes for those three customers and focused only on the remaining customers. For these customers, we distinguished between own-label, own-brand and contract-packed FRM.

Separation of lower-value products

20. When possible, the price changes of low-value FRM products were assessed separately, to allow consideration of whether low-value FRM products were affected disproportionately by the merger (see paragraph 10).

21. Sainsbury's said that cost prices for the basics range would be around [✂]p and cost prices for value range FRM retailing for £1 would be in the region of [✂]p to [✂]p. Kerry noted that its 'entry' and 'standard' tiers would comprise the value range FRM, while its other FRM would be mid-tier or premium products. Moreover, Kerry noted that the wholesale price point for this 'standard' FRM would be [✂]p (in line with Sainsbury's statement). The average exchange rate of sterling to euro was 1.1664 in 2010.[4] Therefore the wholesale price point of 'standard' FRM was around [✂]c. We used 90c as an upper bound of cost price for low value products, ie a product was considered to be 'low value' if its wholesale price was below 90c (in 2010).

The data used

22. We conducted our analysis using data provided by Kerry, which included information on pricing up to August 2011. We used FRM transaction data of the Carrickmacross factory, which included the weekly sales data and monthly cost data at product level. Revenues and costs are in euros. In addition, we used the transaction data for the acquired factories at Flint and Grimsby formerly owned by Headland. For 23 of the products manufactured in these plants we received cost information for the first quarter of 2010. We used those and the growth rate of average unit cost at Carrickmacross to extrapolate their cost in July and August of 2010. In the data for Flint and Grimsby revenues and costs are denominated in sterling.

Kerry's comments on our approach

23. In response, Kerry said that the analysis could not be relied upon to conclude that a direct effect of the merger was a substantial achieved net price increase for FRM. Kerry said that July and August 2010 would not be an appropriate benchmark for comparison with post-merger prices since Kerry had been making losses during that period and that this period had thus been characterized by 'a trough in net prices'.

24. Moreover, in response to our provisional findings report, Kerry added that due to a lag between input cost increases and the implementation of price increases, the net prices before a price increase would show a 'trough' and net prices after a price increase would show a 'peak'. Kerry concluded that the observed net price increase between July/August 2010 and July/August 2011 could not be taken as a conse-

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price increase for all FRM would be less representative for the actual net price increase post-merger. (Similarly, the set of net price increases for the overlap products between August 2010 and August 2011 could be interpreted as a sample of net price changes in other periods.)

[4] Bank of England statistics.

quence of the merger, but would merely reflect an 'upwards phase' in the net price cycle.[5] Moreover, Kerry said that a comparison of net prices immediately before and after the implementation of a price increase would only show an improvement in profitability, which could not on its own amount to evidence of the merger having had an effect on pricing. Kerry concluded that a comparison of net prices immediately after the implementation of a significant price increase to net prices one year earlier would also be likely to show a substantial increase in net prices over that period, given the lag between cost increases and achieved price rises.[6]

25. In Kerry's view the comparison should therefore have been based on longer-term trends in prices.

Our response

26. Two observations show that this is not necessary (and not advisable). First, for Kerry's losses to affect our analysis the net prices of the overlap products considered should have been much lower in July and August 2010 than in other months before and after, leading to the 'trough in net prices' to which Kerry referred.[7] Since we conducted most of our analysis on the month of August it was sufficient to examine Kerry's net prices for these overlap products for August 2010 to see that Kerry's losses did not affect the analysis presented below. The charts included in Annex 1 of this appendix show that Kerry's net prices were not significantly lower in August 2010 than in the months before and after. That is, we did not observe in those charts the 'trough in net prices' in August referred to by Kerry.[8] We were satisfied therefore that these losses did not affect our analysis.

27. These charts also show that around August 2010 there were no 'peaks' in the net prices of the products we considered.[9] The observed net price increase between August 2010 and August 2011 cannot therefore be due to 'troughs' and 'peaks' around August 2010 caused by a lag between the input cost increases and price increases. We agree with Kerry that the observation that net price increased between August 2010 and August 2011 by itself cannot tell us whether this increase was due to the merger. However, we noted that Kerry only sought very substantial price increases post-merger.

28. In addition, prices and input costs in 2010 are still likely to be the most comparable to those in the current year and it is by no means clear that prices and input costs in earlier years such as in July and August of 2009 would be more representative of the competitive pre-merger period.[10] The prices of some ingredients, for example, increased continuously during 2009 and 2010 and the level of these costs in 2010 will be more representative of the period preceding the merger than those in 2009. Since our aim was to consider the effect of the merger on net prices, abstracting as much as possible from effects unrelated to the merger, we therefore preferred a comparison between 2010 and 2011 to a comparison between 2009 and 2011.

29. Second, retailers typically review their FRM range at least twice a year, in spring and autumn. These range reviews reduce the number of comparable products (ie overlap

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[5] Kerry's response to the provisional findings report, paragraph 9.2.
[6] Kerry's response to the provisional findings report, paragraph 14.2.
[7] We note that analysis conducted by Kerry appeared to show a moderate peak in average net price in August 2010, rather than a trough.
[8] The chart for Customer 3's own-brand FRM shown in Figure 14 is an exception to this. Since Kerry explained in the hearing that it had not increased prices on own-brand FRM and since none of its customers stated the opposite, we did not consider this point in more detail.
[9] Again with the exception of the chart for Customer 3's own-brand FRM shown in Figure 14 noted already.
[10] In its response to our provisional findings report, Kerry agreed that this observation was correct (in paragraph 11.1).

products) for earlier years very significantly. Kerry provided us with an analysis of products manufactured at Carrickmacross in both 2009 and 2011. This analysis showed that the number of products manufactured across this time period was only 26, compared with the set of overlap products of 101 FRM for the comparison of 2010 to 2011.[11] Hence a comparison of Kerry's net prices in July and August of 2011 with the same period in earlier years, such as 2009, was very unlikely to be representative of the net price increases post-merger on FRM manufactured at Carrickmacross (a total of 277 FRM in 2010).[12,13,14]

Overall trend

30. Table 1 in our findings shows that the latest effective date of price increases by Kerry was June 2011 (and for a very small number of products, August), so we expected to see any price effects in the July and August data.

31. Table 1 below shows Kerry's volume-weighted average prices and costs of FRM products manufactured at Carrickmacross in July and August in 2010 and 2011, for those that were sold in both periods ('overlap' products). Kerry manufactured 277 FRM products for the six customers of interest (see paragraph 19). Of those, 101 products were sold in July and August in both 2010 and 2011, accounting for 75 per cent of the weight volume and 72 per cent of the revenue in 2010.

32. For the 101 overlap FRM products in July and August, the volume-weighted average gross price per unit of FRM increased by [✂]c per unit in 2011 and the volume-weighted average cost per unit went up by [✂]c, so the volume-weighted average net price per unit increased by [✂]c, an increase of around [✂] per cent. For low-end products, the average net price increased by [✂]c or around [✂] per cent of the 2010 level, which was larger than the overall average increase, suggesting that on average the price increases exceeded input cost increases for all products but that this occurred to a greater extent for low-end FRM products. As the results in Table 1 show, the difference in the gross price for all overlap FRM and low-end FRM was not very large; the difference in the net price increase between all overlap FRM and low-end FRM is hence to a significant extent driven by differences in the unit costs between August 2010 and 2011.

33. The last column of Table 1 reports the p-value of the paired t-test at individual product level on the price or cost equality in two years of 2011 and 2010. As the results in

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[11] Kerry's analysis for 2009 and 2011 considered 26 FRM manufactured at Carrickmacross.

[12] We note that Kerry identified only 97 overlap products instead of the 101 and derived somewhat lower net price increases comparing the periods of July and August 2010 and 2011. Kerry arrived at a net price increase of [✂] per cent for all overlap FRM (compared with [✂] per cent we find for the 101 FRM overlap products we identify) and [✂] per cent (instead of [✂] per cent) for low-value FRM; see Table 1 below for a summary of our results. The information Kerry provided does not allow us to determine why its results differ from ours. Given the relatively small differences, it appears unnecessary to investigate the reasons for these. Similarly, we cannot determine why Kerry identified 29 overlap FRM manufactured at Grimsby and Flint, while based on our data there are only 23 products that were produced in July and August 2010 and 2011.

[13] In response to our analysis, Kerry also stated that these overlap products included those delisted after August 2011 and that, if those were excluded, achieved net prices on products actually still supplied by Kerry after this delisting amounted to only [✂] per cent over 2010 levels for all FRM and [✂] per cent over 2010 levels for low-end FRM, so that the July/August 2011 figures could be regarded as substantially overstating the increase in net prices. Since we are assessing the price increase between August 2011 (the last month in the dataset) and August 2010 it would not be reasonable to exclude products which will be delisted at a later point in time. To the extent that net price increases on such products have been higher, such exclusion would understate the net price changes between August 2010 and 2011. We consider customer switching and prices paid post switching to be important and consider that elsewhere (in paragraphs 7.42–7.49 and in Appendix G).

[14] In its response to our provisional findings report, paragraph 11, Kerry said that there was no reason to believe that this small share of around 8.7 per cent of all FRM products manufactured at Carrickmacross in 2009 would not be sufficient for a fair comparison of the net prices of FRM between August 2009 and August 2011. In our view, this share of products sold in both years was critically low. Since we preferred the comparison of 2010 and 2011 (for reasons spelt out in paragraph 28 above) which also allows considering a larger number of FRM, we did not consider this detail further.

Tables 1 and 2 show, the average net price increases of FRM produced at Carrickmacross as well as Flint and Grimsby are statistically different from zero.

TABLE 1 **Kerry's FRM average prices in July to August (Carrickmacross)**

		2010 c	*2011 c*	*Diff c*	*Change %*	*p-value**
Overall	Unit price	[✂]	[✂]	[✂]	[✂]	0.00
	Unit cost	[✂]	[✂]	[✂]	[✂]	0.00
	Net price	[✂]	[✂]	[✂]	[✂]	0.00
Low end	Unit price	[✂]	[✂]	[✂]	[✂]	0.00
	Unit cost	[✂]	[✂]	[✂]	[✂]	0.00
	Net price	[✂]	[✂]	[✂]	[✂]	0.00

Source: CC analysis of Kerry's data.

*The p-value is the probability to accept the null hypothesis that the price (or cost) in 2011 equals the price (or cost) in 2010; see paragraph 18 for a more detailed explanation.

34. Table 2 is based on the products sold both in July and August 2010 and 2011 by Headland (post-merger by Kerry) at their Flint and Grimsby facilities. The total number of Headland's FRM products in 2010 was 332. Of those only 23 products were sold in July and August 2010 and 2011. The products which were sold in July to August of both years accounted for 14 per cent in weight and 16 per cent in revenue of the total in 2010. The changes in the average unit price, the average unit cost and average net price are reported in Table 2.

35. For the 23 overlap FRM products in July and August, the average volume-weighted net price increased by [✂]c or [✂] per cent of the 2010 level. For low-end products, the average net price increased by [✂]c or [✂] per cent of the 2010 level. The net price increases of both overall and low-end FRM products are statistically significant. We noted that the sample of overlap products manufactured at the factories formerly owned by Headland was relatively small and might not be as representative as the overlap products manufactured at Carrickmacross for Kerry's Carrickmacross transactions. We did not therefore attach as much weight to these results as to the results of the analysis of Carrickmacross products.

TABLE 2 **Headland's FRM average prices in July to August (Flint and Grimsby)**

		2010 p	*2011 p*	*Diff p*	*Change %*	*p-value**
Overall	Unit price	[✂]	[✂]	[✂]	[✂]	0.00
	Unit cost	[✂]	[✂]	[✂]	[✂]	0.00
	Net price	[✂]	[✂]	[✂]	[✂]	0.00
Low end	Unit price	[✂]	[✂]	[✂]	[✂]	0.00
	Unit cost	[✂]	[✂]	[✂]	[✂]	0.00
	Net price	[✂]	[✂]	[✂]	[✂]	0.00

Source: CC analysis of Kerry's data.

*The p-value is the probability to accept the null hypothesis that the price (or cost) in 2011 equals the price (or cost) in 2010; see paragraph 18 for a more detailed explanation.

Individual products

36. Although the average net price across all products increased in 2011, Kerry's ability to increase prices might differ across subsets of products or customers. This might be the case if the conditions of competition were different for the supply of different groups of products or to a certain group of customers. Therefore we also calculated the price change for individual products sold in both periods. Table 3 counts the number of Kerry's 'overlap' products in total as well as those whose gross prices or

net prices increased in the period July and August in 2011 compared with the net prices in July and August of 2010. The lower part of the table shows the price and net price changes in August of 2011 compared with August of 2010. Table 4 shows the equivalent information for Headland. It is worth noting that a product is defined as an FRM supplied to a particular customer.[15] For example, the same branded beef lasagne FRM supplied to Customer 1 and Customer 2 is counted as two products.

TABLE 3 **Kerry (Carrickmacross)**

		Product count	*Kg share in subset of FRM %*	*Rev share in subset of FRM %*	*Kg share of 2010 total %*	*Rev share of 2010 total %*	*p-value*
July–August	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Low-end price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
August	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Low-end price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	

Source: CC analysis of Kerry's data.

Notes:
1. Total number of Kerry FRM products in 2010 is 277.
2. 'Kgs share in subset of FRM' is the weight share of a group of products out of the relevant subset of products produced at Carrickmacross in 2010. Subsets considered here are all overlap FRM and low-value overlap FRM. The entry 86 per cent in the second column, for example, shows that 86 per cent of all overlap FRM were affected by a (gross) price increase.
3. 'Rev share in subset of FRM' is the revenue share of a group of products out of the relevant overlap products in 2010 (all overlap products or low-end overlap products).
4. 'Share of 2010 total' is the share of the given products in all of Kerry's sales of FRM produced at Carrickmacross to customers of interest.
5. See Table 1 for the price and net price changes.
6. The p-value is the probability to accept the hypothesis that the net prices of the relevant group of products in 2010 and 2011 are equal (at product level); see paragraph 18 for a more detailed explanation.

[15] This is done because Kerry may charge different prices on the same product supplied to different customers.

TABLE 4 **Headland (Flint and Grimsby)**

		Product count	*Kg share in subset of FRM %*	*Rev share in subset of FRM %*	*Kg share of 2010 total %*	*Rev share of 2010 total %*	*p-value*
July–August	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.01
	Price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.01
	Low-end price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
August	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Low-end price rose	[✂]	[✂]	[✂]	[✂]	[✂]	
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]	

Source: CC analysis of Kerry's data.

Notes:
1. Total number of Kerry FRM products in 2010 is 332.
2. 'Kgs share in subset of FRM' is the weight share of a group of products out of the relevant subset of products produced at Flint and Grimsby in 2010. Subsets considered here are all overlap FRM and low-value overlap FRM. The entry 84 per cent in the second column for example shows that 84 per cent of all overlap FRM were affected by a (gross) price increase.
3. 'Rev share in subset of FRM' is the revenue share of a group of products out of the relevant overlap products in 2010 (all overlap products or low-end overlap products).
4. 'Share of 2010 total' is the share of the given products in all of Kerry's sales of FRM produced at Flint and Grimsby to customers of interest.
5. See Table 2 for the price and net price changes.
6. The p-value is the probability to accept the hypothesis that the net prices of the relevant group of products in 2010 and 2011 are equal (at product level); see paragraph 18 for a more detailed explanation.

37. As noted in paragraph 22, price increases were only implemented in June 2011 (and to a very small extent in August), therefore we focused on the net price changes in August 2011 compared with August of 2010 in the following analysis of net price increases by product segment and by customer.

38. Table 1 in Annex 4 of this appendix lists the products whose net prices increased in August including their 2010 sales rank based on weight volume sold within Kerry's total weight volume of FRM sold to customers of interest manufactured at Carrickmacross, cuisine, type, unit price and net price increase. The sales ranks were widely distributed, suggesting that net prices of best-selling products were not necessarily more likely to have risen; the cuisines included beef lasagne, other Italian, chicken curry, other Indian, traditional British and oriental; product types were contract-pack, own-brand and own-label; and the gross unit prices ranged from [✂]c to [✂]c in 2010.

39. Table 2 in Annex 4 shows the equivalent for products previously manufactured by Headland at Flint and Grimsby, but there are only 14 overlap products which is a less representative sample. Therefore we focused on Kerry's Carrickmacross transactions to assess the price effects by product segment and by customers.

Product types

Contract packed/own brand/own label

40. Table 5 shows the number of products whose gross prices and net prices increased in August 2011 compared with August 2010 and shows their volume and revenue shares in 2010.The shares reported in columns three and four are those in the given segment, while those in columns five and six are those in all sales of overlap FRM manufactured at Carrickmacross to the customers in the dataset in 2010. The net

price in 2010 and its change for each segment are reported in the three columns on the right.

TABLE 5 **August price comparison—contract packed/own brand/own label**

	Product count	*Kg share in segment %*	*Rev share in segment %*	*Kg share of all overlap %*	*Rev share of all overlap %*	*Net price 2010 c*	*Net price diff c*	*Net price change %*	*p-value*
Contract packed									
Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.18
Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.03
Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Own brand									
Overlap	21	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.02
Gross price rose	18	[✂]	[✂]	[✂]	[✂]				
Net price rose	16	[✂]	[✂]	[✂]	[✂]				
Low-end overlap	19	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
Low-end gross price rose	16	[✂]	[✂]	[✂]	[✂]				
Low-end net price rose	16	[✂]	[✂]	[✂]	[✂]				
Own label									
Overlap	64	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
Gross price rose	60	[✂]	[✂]	[✂]	[✂]				
Net price rose	46	[✂]	[✂]	[✂]	[✂]				
Low-end overlap	40	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
Low-end gross price rose	40	[✂]	[✂]	[✂]	[✂]				
Low-end net price rose	29	[✂]	[✂]	[✂]	[✂]				

Source: CC analysis of Kerry's data.

Notes:
1. There is only one contract-packed customer supplied from Carrickmacross.
2. The p-value is the probability to accept the hypothesis that the net prices of the relevant group of products in 2010 and 2011 are equal (at product level); see paragraph 18 for a more detailed explanation.

41. [✂] of [✂] contract-packed products saw a net price increase; all of them were low-end products. Out of [✂] low-end contract-packed products, the net prices of [✂] of them increased in 2011, accounting for [✂] per cent of the volume and revenue of overlap low-end contract-packed products.[16] The net price of all overlap contract-packed FRMs taken together decreased by [✂] per cent but the decrease was not statistically significant (p-value is 0.18) whereas the net price of low-end contract-packed FRMs taken together increased by [✂] per cent and the increase was statistically significant (p-value is 0.03). There was only one customer of contract-packed FRM manufactured at Carrickmacross, and as can be seen from the price and cost movements in Figure 16 in Annex 1, its gross and net prices were lower in August 2011 than that in August 2010.

42. In fact, information from this customer on its total spend on FRM supplied by Kerry post-merger implied that Kerry's cost prices post-merger were on average [✂] (see the results for contract-packed FRM in Table 5 above).

43. Table 6 shows the price changes and net price changes for that customer's overlap products in August. Low-end FRM are indicated by a 0 in the column 'low-end', while more 'up-market' FRM have the entry 1. The net prices of the [✂] mid-tier FRM decreased to a larger extent than the net price of the [✂] low-value FRM increased, which explains the difference between the net price changes of all contract-packed overlap FRM and low-value contract-packed overlap FRM shown in Table 5 above.

[16] The volume and revenue are in terms of the sales in 2010.

TABLE 6 **A customer's overlap products in August**

Product	Low end	Net price rose	Vol rank 2010	Unit price 2010 c	Unit price 2011 c	Price diff c	Net price 2010 c	Net price 2011 c	Net price diff c
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Kerry's data.

44. Looking at all overlap own-brand products manufactured at Carrickmacross, the net prices of [✂] of the [✂] own-brand overlap products increased in August 2011 compared with August 2010, accounting for around [✂] per cent of the volume and revenue of the overlap own-brand products. Net prices of around 85 per cent of the low-end overlap own-brand FRM, in terms of both volume in kg and revenue, increased. The difference of the net prices in August 2010 and August 2011 of both overall and low-end own-brand FRM products are statistically significant (p-values are 0.02 and 0.00). The results summarized in Table 5 hence show that net prices of own-brand FRM increased (as did those of own-label FRM).

45. Out of [✂] own-label overlap products manufactured at Carrickmacross, the net prices of [✂] increased in 2011, accounting for around 80 per cent of volume and revenue of overlap own-label products. The average net price of overlap own-label products increased by [✂]c or by [✂] per cent. The net price increase of low-end own-label products was even larger. Both the net prices are statistically different in August 2010 and August 2011 (p-values are 0.00).

46. This suggested that for the customers considered, the merger may in the short run have had a significant direct price effect on the supply of own-brand and own-label products, but only a moderate effect on low-end contract-packed products if any effect at all. As explained in paragraph 14, the data does not allow us to conclude whether these will persist in the medium or long term.

Cuisine

47. We considered four broad categories of cuisine: traditional British, Indian, Italian and oriental. Because some customers pointed out the importance of beef lasagne and chicken curry in their range and the large sales volumes of these products, we separated them from other Italian and Indian meals. As a result, we looked at four cuisine groups and two individual products types. For simplicity we referred to those six product groups as 'cuisines' below. Table 7 shows the number of overlap products and number of those products which saw a price increase in August 2011 compared with August 2010 by cuisine and also includes their shares in the total for the given cuisine and in the total of all overlap products.

TABLE 7 **August price comparison—by cuisine**

		Product count	*Kg share in subset of FRM %*	*Rev share in subset of FRM %*	*Kg share of 2010 total %*	*Rev share of 2010 total %*	*Net price 2010 c*	*Net price diff c*	*Net price change %*	*p-value*
Beef lasagne	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.10
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.16
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
British	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.08
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Chicken curry	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.01
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.02
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Other Indian	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.04
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.02
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Other Italian	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.21
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.10
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Oriental	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.04
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.01
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				

Source: CC analysis of Kerry's data.

Note: The p-value is the probability to accept the hypothesis that the net prices of the relevant group of products in 2010 and 2011 are equal (at product level); see paragraph 18 for details.

48. The net prices increased for a significant portion of every group of FRM products, in terms of number of products, volume and revenue. Four cuisines (not chicken curry nor traditional British FRM overall) and low-value traditional British FRM products experienced a double digit percentage net price increase.[17] Among those cuisines which saw such large net price increases, only the net prices of beef lasagne, other Italian FRM and British FRM were not statistically significantly different in August 2010 and August 2011 at the conventional 5 per cent significance level. The net prices for beef lasagne and British FRM overall were statistically significantly different in both months of August at the lower level of significance of 10 per cent. The same applied for low-end other Italian FRM. In fact at this higher level only the net prices of low-end beef lasagne and other Italian meals overall were not statistically different in August 2010 and August 2011. For beef lasagne and other Italian FRM, the lack of statistical significance or significance only at a higher threshold may have been due to the small number of products included. The net price increases of low-end products were generally larger and statistically significant at lower levels of significance (except beef lasagne and chicken curry for which the significance levels of overall and low-end were similar). This was consistent with customers commenting that low-value products were most affected by the merger.

49. For chicken curry FRM, as shown in Figure 6 in Annex 1, the average gross price increased in August 2011 compared with August of 2010. However, the gross price increase was eroded by the direct cost increase and therefore the net price increase was [✂] per cent.

50. This evidence suggested that for the customers considered, the merger may have had a significant direct price effect, in terms of both the size of price increase and its statistical significance, on the supply of low-value traditional British, other Indian and oriental FRM at least in the short run. For beef lasagne and other Italian FRM, the size of the price increase was large but not statistically significant at the conventional level of 5 per cent. The merger only had a moderate effect at most on chicken curry FRM. Again, as explained in paragraph 14, the data does not allow us to conclude whether these will persist in the medium or long term.

Customers

51. We considered whether the net prices and their changes after the merger varied by customer, due to differences in strength of customers' bargaining positions. Table 8 shows the number of products and the number of products whose prices and net prices increased in August 2011 by customer and by type as well as the net price changes for these customers.

[17] The difference of net price increases between all and non-low-end traditional British FRM explains that the net price of non-low-end traditional British FRM did not increase.

TABLE 8 **August price comparison—by customer**

		Product count	*Kg share in total sold to customer %*	*Rev share in total sold to customer %*	*Kg share of all overlap %*	*Rev share of all overlap %*	*Net price 2010 c*	*Net price diff c*	*Net price change %*	*p-value*
Customer 1 own label	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.03
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.12
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 2 own label	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 2 own brand	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.42
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.00
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 3 own label	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.25
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.17
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 3 own brand	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.02
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 4 contract packed	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.18
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.03
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 5 own label	Overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	0.25
	Gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
Customer 5 own brand	Low-end overlap	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	-
	Low-end gross price rose	[✂]	[✂]	[✂]	[✂]	[✂]				
	Low-end net price rose	[✂]	[✂]	[✂]	[✂]	[✂]				

Source: CC analysis of Kerry's data.

Notes:

1. The p-value is the probability to accept the hypothesis that the net prices of the relevant group of products in 2010 and 2011 are equal (at product level); see paragraph 18 for details.
2. Columns 3 and 4 show the weight and revenue shares in the total overlap FRM of the given segment sold to the given customer (of those produced at Carrickmacross) and columns 5 and 6 show the weight share and revenue share in Kerry's total sales of overlap FRM produced at Carrickmacross to the six customers in 2010.
3. Customer 1 and Customer 3 did not buy the same own-brand products in August 2010 and 2011.
4. There are no overlap products sold to a sixth customer in August 2010 and 2011.
5. All Customer 3's overlap products are own brand.
6. There are no low-end own-label overlap products for Customer 5.

52. From the first three columns, we saw that the net prices increased for a significant share of every customer's FRM products, in terms of number of products, volume and revenue. The smallest volume and value shares of FRM products affected by net price increases were those for Customer 5's own-label FRM, still amounting to 21 per cent. (This excluded own-brand FRM supplied to Customer 5, for which there was only one overlap product.)

53. The net price increases of low-end products were generally somewhat larger than those for all overlap products jointly (except own-label FRM supplied to Customer 3, whose overall own-label products experienced a higher percentage increase of net price, driven by the larger volume of a premium product with high net price in August 2011).[18] This was consistent with customers commenting that low-value products were most affected by the merger.[19]

54. The average net price of Customer 1's own-label products did not increase in 2011. This was because the gross price increases of Customer 1's own-label products in August 2011 (compared with August 2010) were eroded by the direct cost increases in the same period, such that their net prices did not increase (see Figure 11).

55. The average net prices of Customer 5's own-brand and own-label products did not increase in August 2011 compared with August 2010 either. As shown in Figure 17, which plots the volume-weighted average price and cost of six overlap own-brand FRM in July and August 2010 and 2011, Customer 5's own-brand FRM gross price peaked in August and September 2010, when it was higher than the gross price in August 2011, but the unit cost was relatively stable after August 2010. Therefore the average net price of Customer 5's own-brand FRM did not increase in August 2011 relative to August 2010. (We note that the results of Customer 5's own-brand FRM in Table 8 are for a single frozen ready meal sold in August 2010 and 2011, whereas Figure 17 is based on six own-brand products sold in July and August of two years.) The gross price increase of Customer 5's own-label products in August 2011 (compared with August 2010) was eroded by the direct cost increase in the same period (Figure 18). The observation that the difference of net price of own label in August 2010 and August 2011 was not statistically different from zero was probably due to the small number of own-label overlap products sold to Customer 5.

56. The net prices of Customer 2's own-label and own-brand products increased by [✂] per cent and [✂] per cent respectively. However, the difference in net prices in August 2010 and August 2011 for all own-brand FRM was not statistically significant at a product level, whereas the difference was statistically significant for own-label and low-end own-brand FRM. The average net price increase was explained by the marked gross price increases starting from May 2011, which were more pronounced than the increases of the direct costs (see Figures 12 and 13).

57. The net prices of Customer 3's own-label and own-brand products increased significantly (by [✂] per cent and [✂] per cent respectively).[20] When tested at the product level, the net price difference between the two months of August was not statistically significant for own-label FRM (p-value is 0.25), whereas the difference was signifi-

[18] Although the volume-weighted average net price increase of low-end products is larger, given the small number of overlap products in the data set, we could not test whether the difference is statistically significant.
[19] The results for the remaining customer are identical to those for contract-packed FRM in Table 5 above and are therefore not discussed again here.
[20] The high percentage net price increase of Customer 3's products, which is different from what Customer 3 has told us, may be due to: *(a)* the price increases Customer 3 gave us is not the month-to-month difference in 2010 and 2011 as analysed here; *(b)* this analysis only looks at a subset of FRM and the sample size (number of overlap products) is small, therefore the results may not be representative and may be affected to a large extent by the sale and price change of a single product; *(c)* possible typo of data entries in Kerry's Carrickmacross transactions.

cant for own-brand FRM (p-value = 0.02). We noted that the t-test result for own-label product might not be reliable due to the small number of [less than ten] products involved. Again, the average net price increase was explained by the marked gross price increases starting from May 2011, which were more pronounced than the increase of the direct costs of these FRM (Figures 14 and 15).

Prices of FRM and CRM

58. CRM and FRM have similar inputs, production processes and distribution channels.[21] If the intensity of competition in the supply of CRM did not change, but the merger substantially lessened competition in the supply of FRM, we might expect to see any net price increases of FRM products to be significantly larger relative to the net price increases of CRM products after the merger, or net price decreases for FRM to be smaller than for CRM.

59. This analysis is subject to caveats that if we did not see such differences it would not necessarily indicate a lack of unilateral effects: first, the merged company may have moderated its behaviour to date, aware that it may be under scrutiny from competition authorities, or may have altered elements other than price; secondly, any unrelated changes in the competition conditions in CRM supply would weaken the results; and thirdly, changes in other conditions in the supply of either FRM or CRM for which we are not able to control, such as a demand shock or a capacity constraint in the supply of one but not the other, could impact on this analysis.

60. We used the FRM and CRM transaction data of Kerry's Carrickmacross factory.[22] The FRM data is the same as in the previous analysis. The CRM data includes weekly revenues and costs at product level in pounds sterling. It is worth noting that the currency for FRM is euros and the currency for CRM is pounds sterling.

Overall trend

61. Table 9 shows the average unit prices, unit costs and unit net prices of Kerry's CRM products in July and August in 2010 and 2011. The prices and cost are given in pence. Both the unit cost and unit price of CRM increased in 2011 and the net price increased by [✂] per cent.

TABLE 9 **Kerry's CRM average prices in July/August**

	2010 *p*	*2011* *p*	*Difference* *p*	*Change* *%*
Unit price	[✂]	[✂]	[✂]	[✂]
Unit cost	[✂]	[✂]	[✂]	[✂]
Net price	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Kerry's data.

Note: The price and cost are the volume weighted average of all of Kerry's CRM products.

62. More importantly, this table can be compared to Table 1 for FRM. The average gross price of FRM increased (around [✂] per cent) significantly more than that of CRM (around [✂] per cent). We also note that the unit costs increased to a greater extent

[21] We have been told that CRM are more labour intensive and tend to use more expensive higher-quality inputs and some inputs that do not keep their taste when frozen.
[22] Headland did not produce CRM. Therefore we cannot derive a comparison for CRM produced by Headland, nor compare the FRM and CRM change in the net prices for Headland customers.

for FRM than for CRM. Overall, the net price of FRM increased by around [✂] per cent, which is only slightly larger than the net price increase of CRM ([✂] per cent).[23]

63. The FRM and CRM net price changes comparison broken down by cuisine and by customer is discussed in Annexes 2 and 3 of this appendix. The results considering price changes by cuisine were mixed. While the net price increase was larger for FRM than for CRM for Indian, other Italian and oriental meals—consistent with a stronger effect of the merger on competitive conditions in the supply of FRM than in the supply of CRM—the net prices of chicken curry increased more for CRM than for FRM. The breakdown of price changes by customer showed that the findings were consistent with a direct effect of the merger on FRM net prices as opposed to CRM prices only for Customer 3, but not for Customers 1 and 5 (there were no comparable overlap FRM and CRM for other customers).

64. Overall, the comparison of net price changes for FRM and CRM did not show that net price increases have been consistently larger for FRM than for CRM; as such, the findings were not conclusive either way.

Evidence on non-price aspects

65. Kerry might use any increased market power post-merger to worsen non-price aspects of its offer to its customers. Increased market power post-merger might allow Kerry not only to increase prices, but also to worsen aspects such as contract conditions, product quality or service level. This would be a direct effect of the merger. We set out here the evidence on such harm.

66. As for direct effects on price, we note that while evidence of non-price harm due to the merger can provide good evidence of effects of this completed merger, the converse is not true. As explained above, absence of such effects may be due to Kerry adjusting its behaviour to ongoing regulatory scrutiny and does not necessarily indicate that the merger is not problematic.

Deterioration of Kerry's offer

67. Customers' experience regarding non-price effects of the merger differed significantly. A number of customers did not notice any significant deterioration of Kerry's offer, while others mentioned problems that appeared to them to be due, or at least partially due, to Kerry struggling to integrate both companies. Sainsbury's in particular said that it experienced a surge in problems with FRM supplies from Kerry post-merger. In response, Kerry said that the issues raised by Sainsbury's were not merger-related.

[23] Although the FRM and CRM of the same dish (eg beef lasagne) share similar raw materials cost, their unit costs can move differently, which include raw materials, direct labour and other direct expenses.

Kerry's FRM price movement

1. All the charts in this annex are based on the set of FRM products manufactured at Carrickmacross that were sold in July to August 2010 and 2011. Therefore, the sample of products in this annex is the same as for the comparison for July/August in the main text, but is somewhat larger than that for the analysis for August alone. We use the somewhat larger sample for overlap FRM in July and August since otherwise the average gross price, net price and unit cost for some of the other months shown in the charts below would be based on a very small sample. The discussion of the graphs is in the main text.

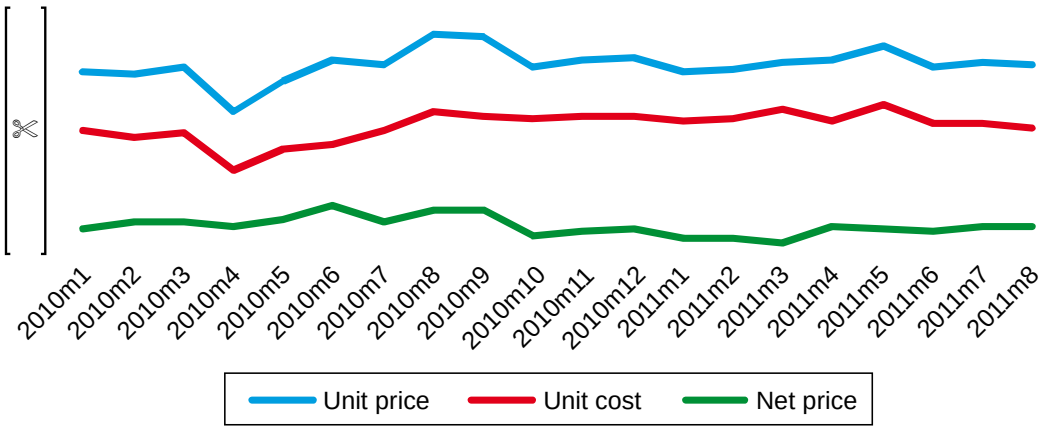
Product types

Contract packed/own brand/own label

2. Figures 1, 2 and 3 plot the prices and costs of contract packed, own brand and own label products respectively, from January 2010 to July 2011.

FIGURE 1

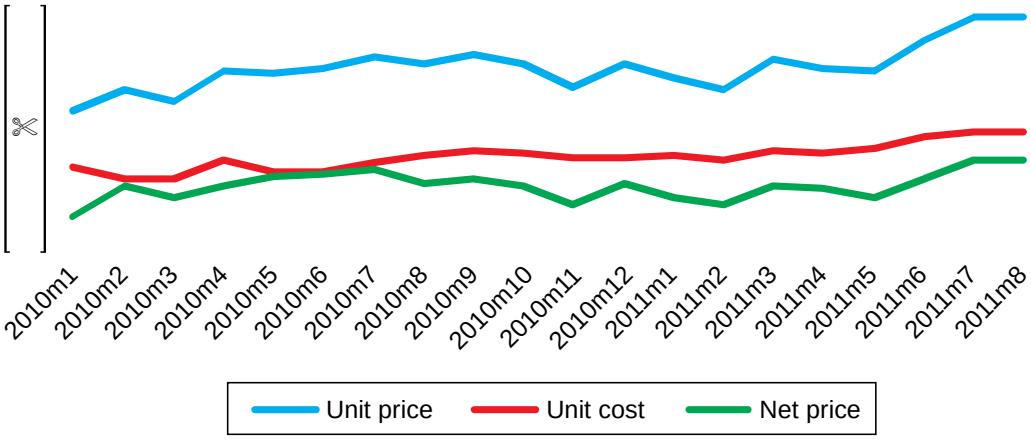
Kerry contract packed



Source: CC analysis of Kerry's data.
Note: All contract-packed FRM manufactured at Carrickmacross are produced for one customer.

FIGURE 2

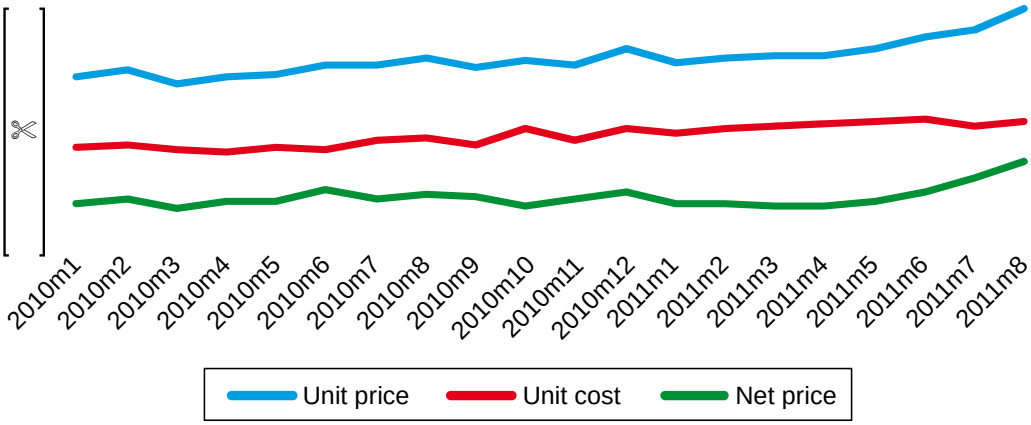
Kerry own brand



Source: CC analysis of Kerry's data.

FIGURE 3

Kerry own label



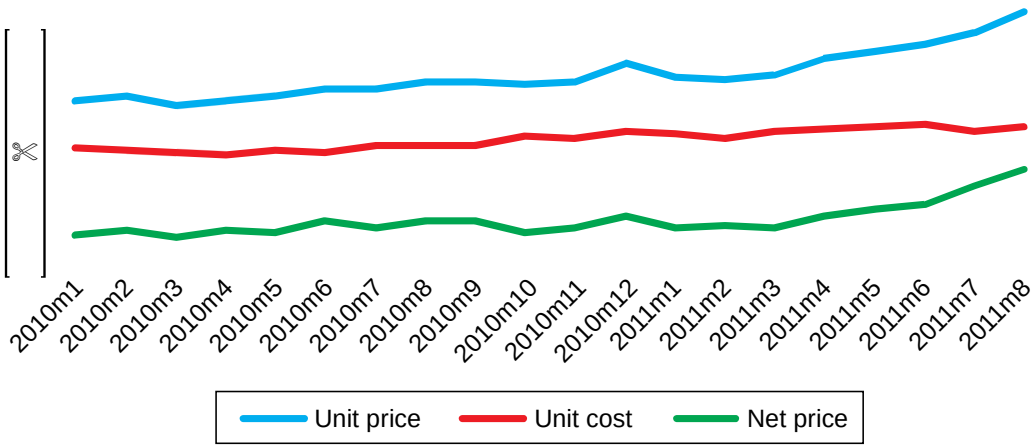
Source: CC analysis of Kerry's data.

Cuisine

3. Figures 4 to 9 plot the price and cost movements of FRM products by cuisines.

FIGURE 4

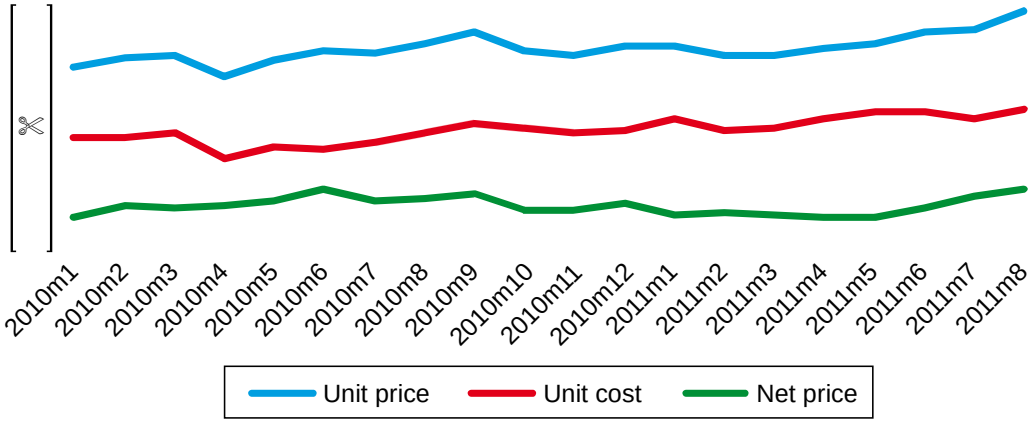
Beef lasagne



Source: CC analysis of Kerry's data.

FIGURE 5

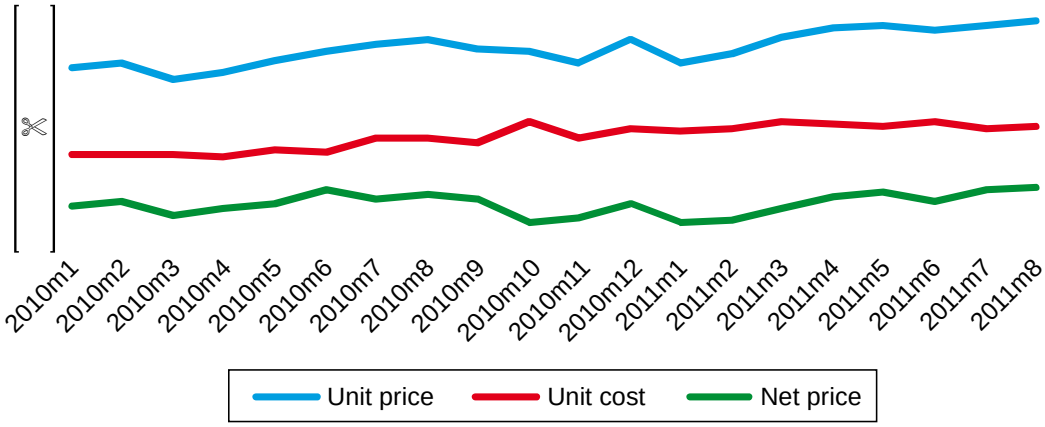
Traditional British



Source: CC analysis of Kerry's data.

FIGURE 6

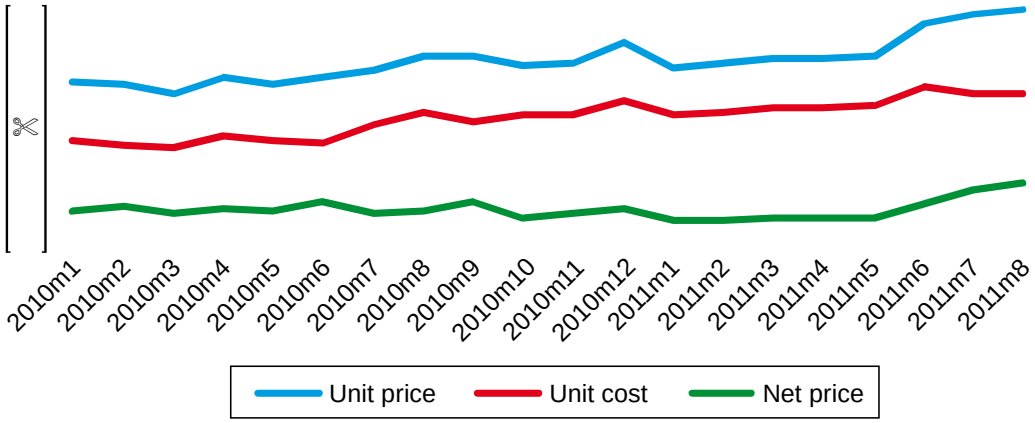
Chicken curry



Source: CC analysis of Kerry's data.

FIGURE 7

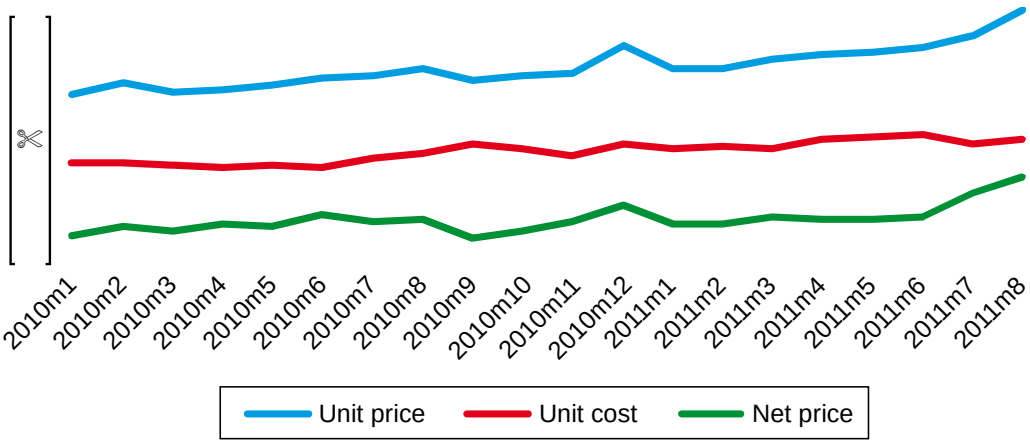
Other Indian



Source: CC analysis of Kerry's data.

FIGURE 8

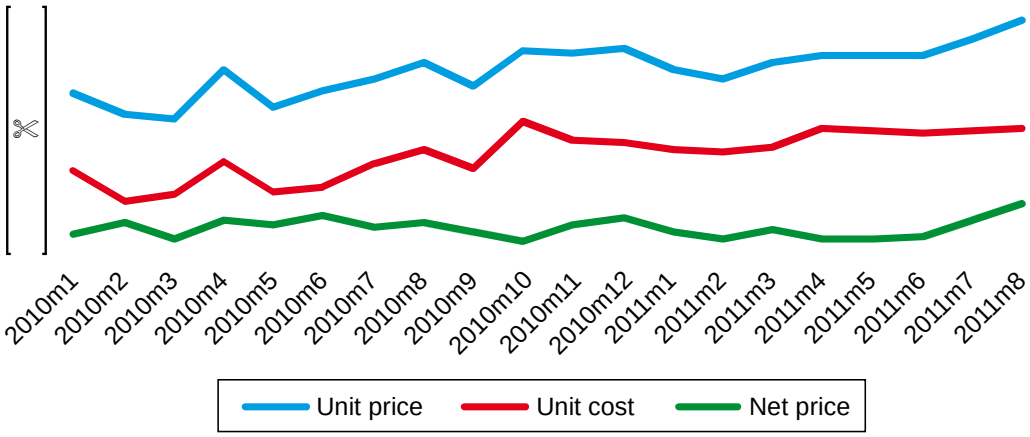
Other Italian



Source: CC analysis of Kerry's data.

FIGURE 9

Oriental



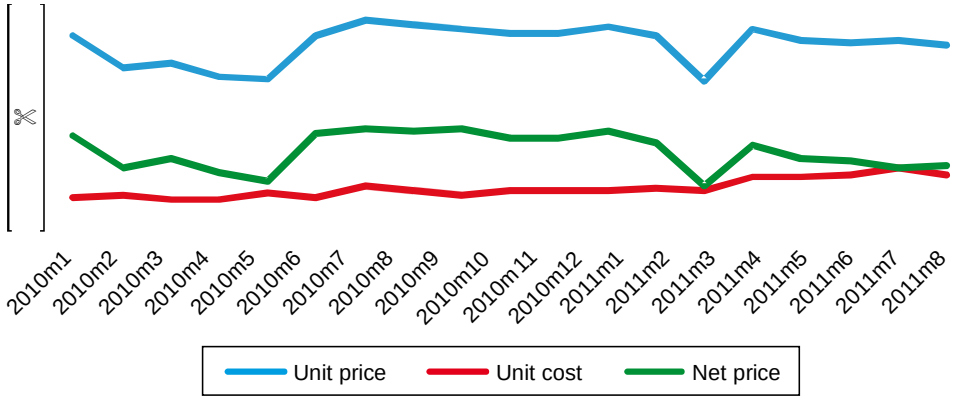
Source: CC analysis of Kerry's data.

Customers

4. Figures 10 to 18 show the FRM prices and costs by customers who have continuous monthly information since January 2010.

FIGURE 10

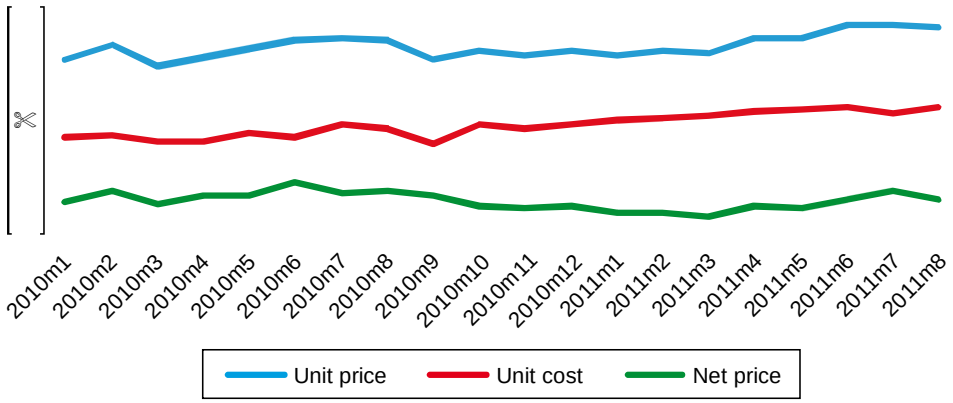
Customer 1 own brand



Source: CC analysis of Kerry's data.

FIGURE 11

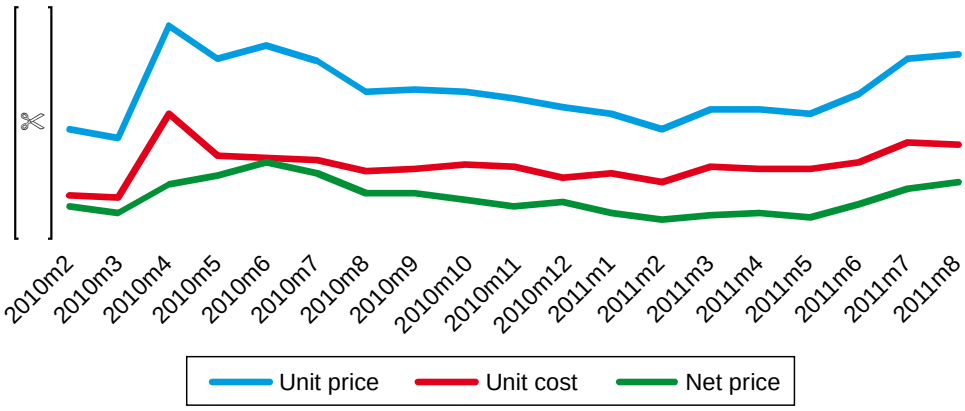
Customer 1 own label



Source: CC analysis of Kerry's data.

FIGURE 12

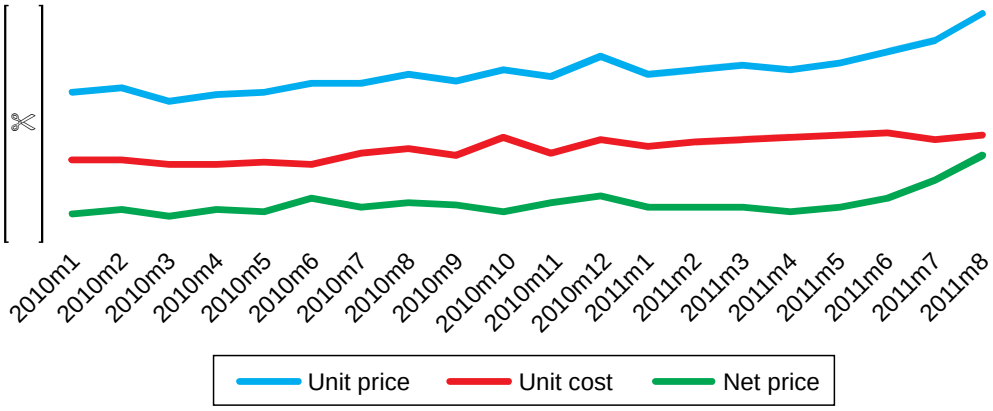
Customer 2 own brand



Source: CC analysis of Kerry's data.

FIGURE 13

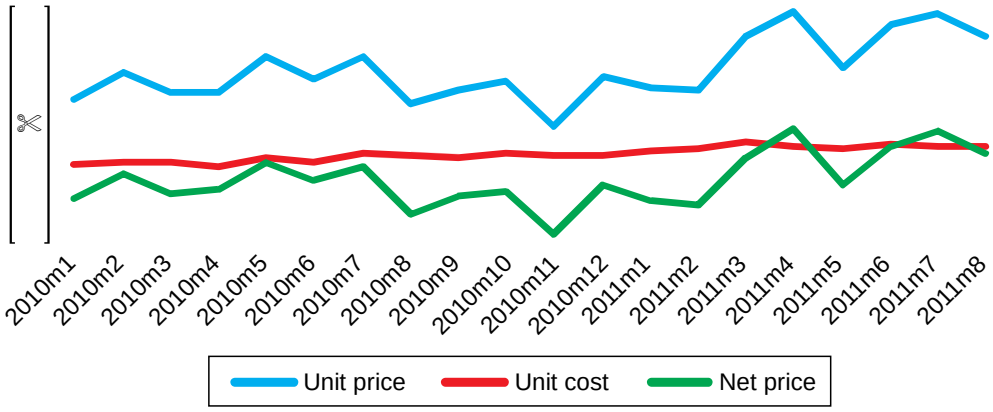
Customer 2 own label



Source: CC analysis of Kerry's data.

FIGURE 14

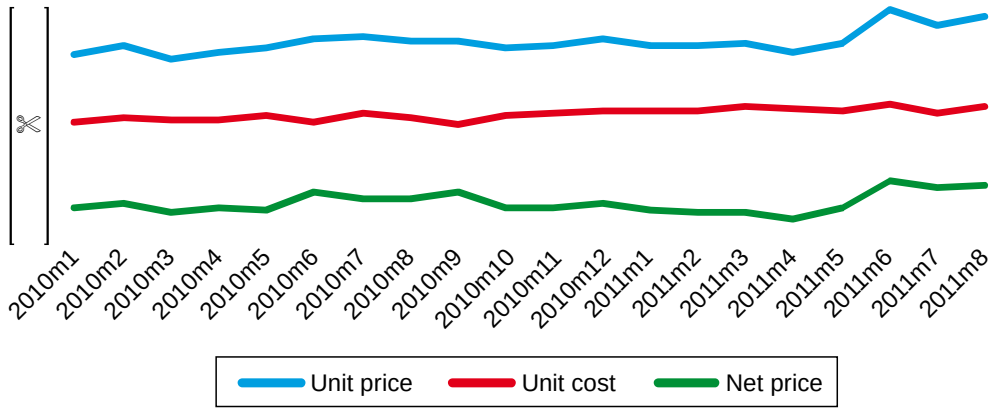
Customer 3 own brand



Source: CC analysis of Kerry's data.

FIGURE 15

Customer 3 own label



Source: CC analysis of Kerry's data.

FIGURE 16

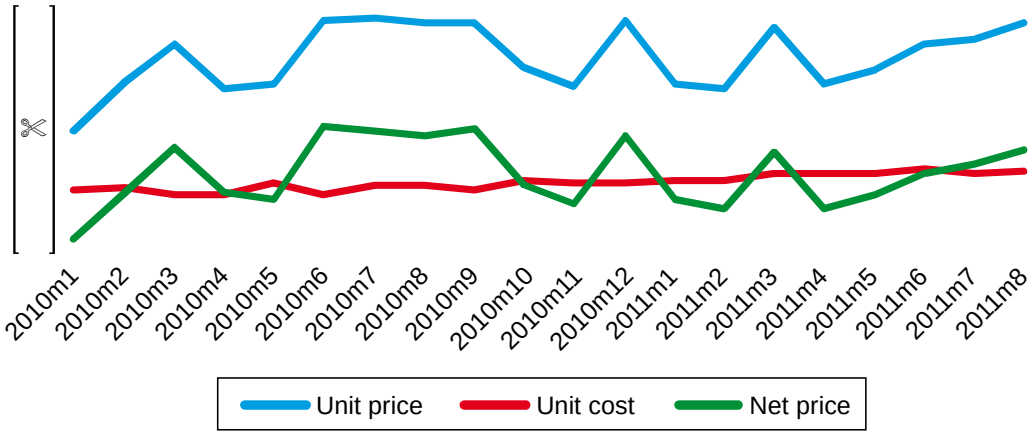
Customer 4 contract packed

[✂]

Source: CC analysis of Kerry's data.

FIGURE 17

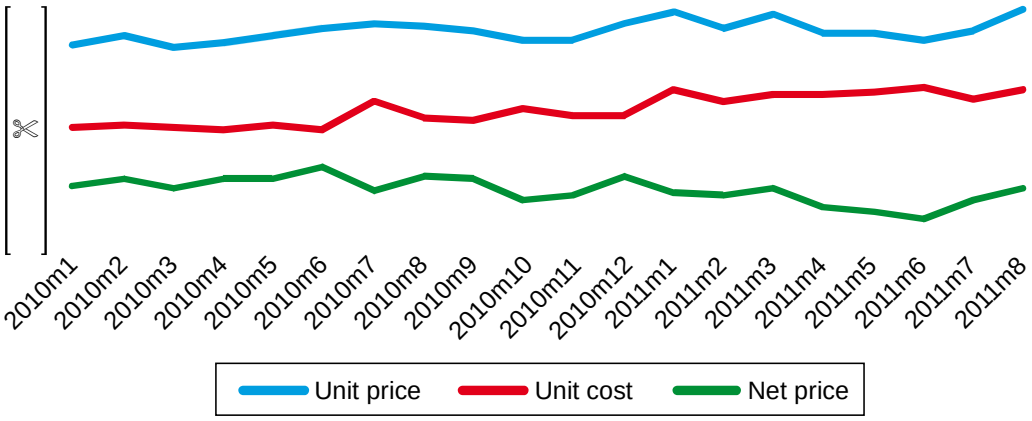
Customer 5 own brand



Source: CC analysis of Kerry's data.

FIGURE 18

Customer 5 own label



Source: CC analysis of Kerry's data.

Prices of FRM and CRM—breakdown

1. This annex compares net price changes of FRM and CRM by product segment and by customer for August 2010 and August 2011.

Cuisine

2. Kerry does not produce chilled beef lasagne. The chilled traditional British meals consist of chicken in red wine and Scottish beef, which are not produced as frozen meals. If these are excluded, the data set does not contain data for August 2011, which makes the comparison of net prices in August 2010 and 2011 impossible. Therefore we cannot compare the CRM and FRM net prices for beef lasagne and traditional meals and are left with four cuisines. Table 1 compares the average unit net prices of FRM and CRM by cuisine in August of 2010 and 2011.

TABLE 1 **Net price comparison of CRM and FRM in August**

			2010	*2011*	*Difference*	*% change*
Chicken curry	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
Indian	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
Italian	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
Oriental	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Kerry's data.

Note: The price and cost for CRM are in pence; the price and cost for FRM are in cents.

3. The net prices of frozen chicken curry increased by [✂] per cent, while those of chilled chicken curry increased by [✂] per cent, which is not consistent with prices of FRM increasing to a greater extent than those for CRM as a consequence of the merger.

4. For other Indian and other Italian meals, the net prices of FRM increased more than those of CRM. For oriental meals, the net price of FRM increased whereas the net price of CRM decreased. In other words, the price increase for other Indian, other Italian and oriental frozen meals was larger than for respective chilled meals. This observation was consistent with the merger affecting competitive conditions in the supply of FRM.

Customers

5. Table 2 shows the net price changes of CRM and FRM by customers in August 2010 and 2011. Kerry did not supply CRM to three of the customers considered here and therefore these three customers are not included below.

TABLE 2 **Net price comparison of CRM and FRM in August**

			2010	*2011*	*Difference*	*% change*
Customer 1	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
Customer 3	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
Customer 5	CRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]
	FRM	Unit gross price	[✂]	[✂]	[✂]	
		Unit cost	[✂]	[✂]	[✂]	
		Unit net price	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Kerry's data.

6. For Customer 1 and Customer 5, the net prices of FRM did not increase while the net prices of CRM supplied by Kerry increased by [✂] and [✂] per cent respectively. This evidence was not consistent with an effect of the merger on competitive conditions in the supply of FRM.

7. The net price of FRM for Customer 3 increased by [✂] per cent while that of CRM decreased by [✂] per cent.[24] This might be seen as some indication of a merger effect on the prices charged to Customer 3 (although the comparison of the average net price increases of FRM and CRM overall does not suggest such an effect; compare the results in Tables 1 and 9 in the main text). We note that the net price decrease of Customer 3's CRM might be attributed to its larger unit cost increase which Kerry was not able to pass on.

[24] We note that the large net price increase of own-brand FRM supplied to Customer 3, which is not consistent with what Customer 3 told us, is the main driver of this result. If this comes from data errors, the reliability of a price effect for Customer 3's own-brand FRM will be weakened.

FRM and CRM net prices movement

1. All the charts in this annex are based on the set of products that were sold in July/ August 2010 and 2011. This sample is the same as for the comparison for July/ August in the main part of this appendix and somewhat larger than the sample for the analysis for August alone.[25]

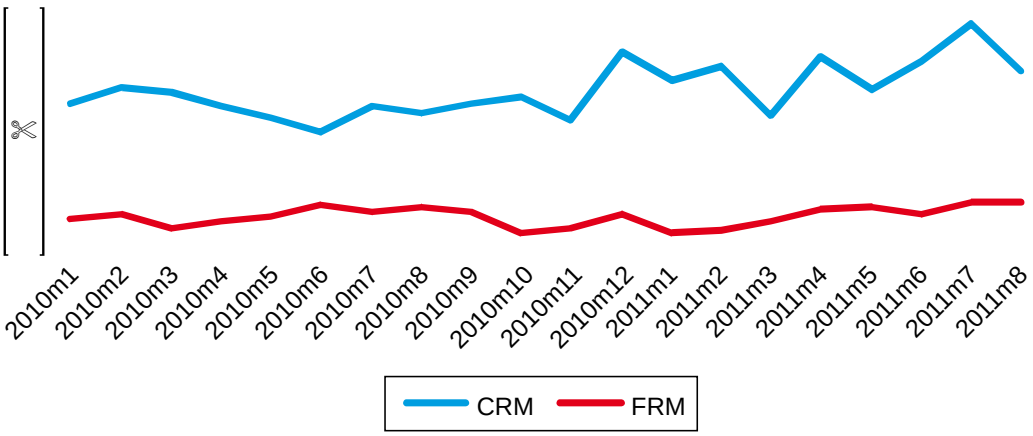
Product types

Cuisine

2. Figures 1 to 4 below plot the average unit net prices of FRM and CRM by cuisine from January 2010. Kerry does not produce chilled beef lasagne, and we excluded traditional British meals for its lack of continuous monthly observations in 2010 and 2011, so we could consider only four cuisines in this comparison.

FIGURE 1

Chicken curry unit net price



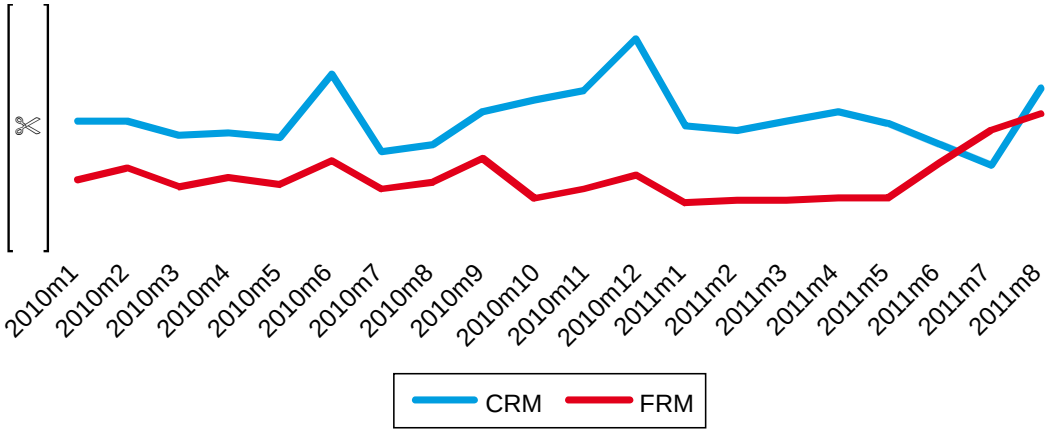
Source: CC analysis of Kerry's data.

3. For chicken curries, the gap between the net prices of CRM and FRM expanded from November 2010, with CRM increasing and FRM being stable.

[25] As for the charts of FRM prices and unit costs, using the somewhat larger sample for overlap FRM in July/August is preferable here since otherwise the average gross price, net price and unit cost for some of the other months shown in the charts below would be based on a very small sample.

FIGURE 2

Indian unit net price

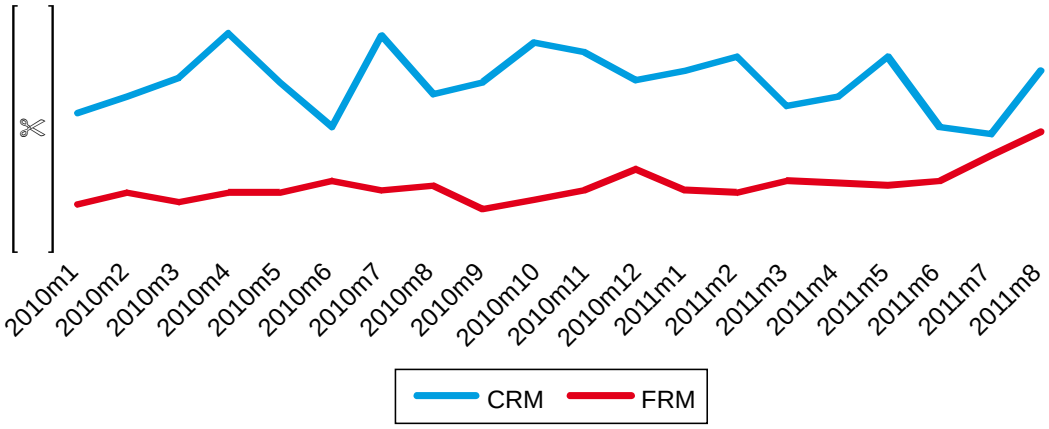


Source: CC analysis of Kerry's data.

4. For other Indian meals, net prices of CRM and FRM followed a similar trend but after May 2011, the net price of FRM began to increase while the net price of CRM started to fluctuate.

FIGURE 3

Italian unit net price

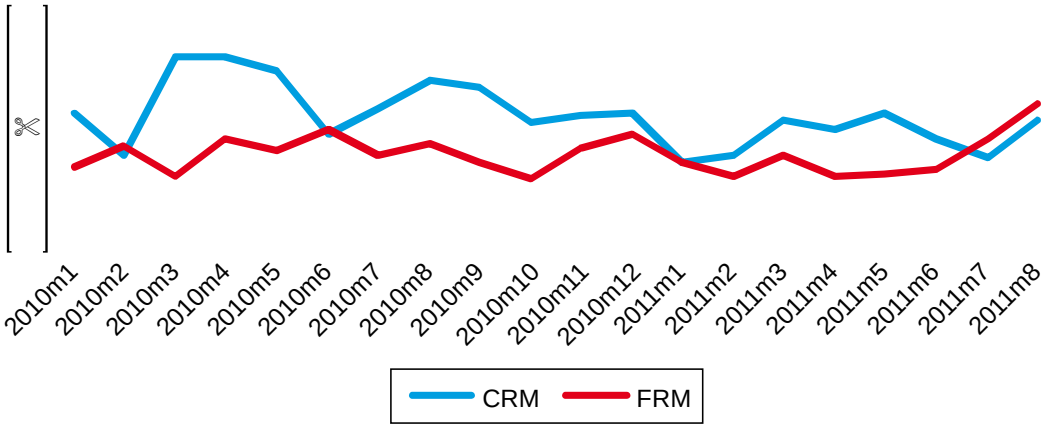


Source: CC analysis of Kerry's data.

5. For other Italian meals, the gap in net prices between CRM and FRM narrowed, due to the increase in FRM net prices since June 2011.

FIGURE 4

Oriental unit net price



Source: CC analysis of Kerry's data.

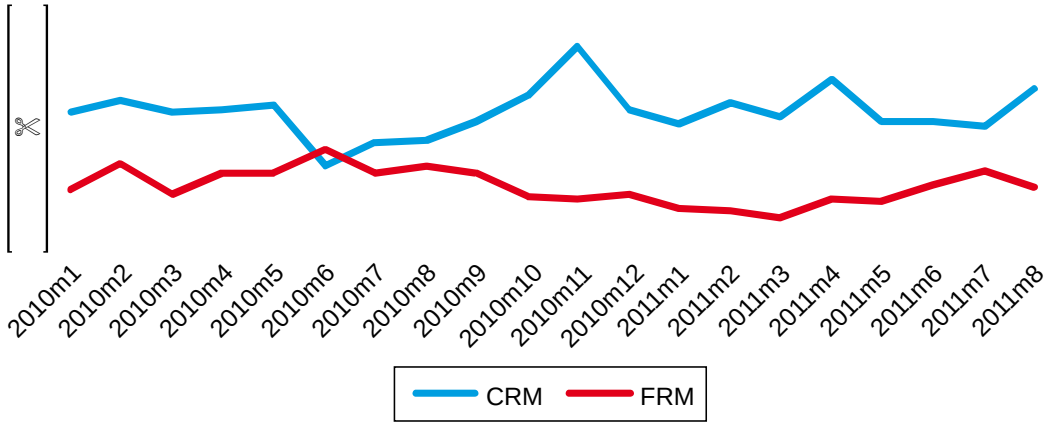
6. For oriental meals, the gap in net prices between FRM and CRM fluctuated, because of the volatility of CRM net prices and the net price increase of FRM after June 2011.

Retailers

7. Figures 5 to 7 plot the net prices of CRM and FRM by retailer since January 2010.

FIGURE 5

Customer 1 unit net price

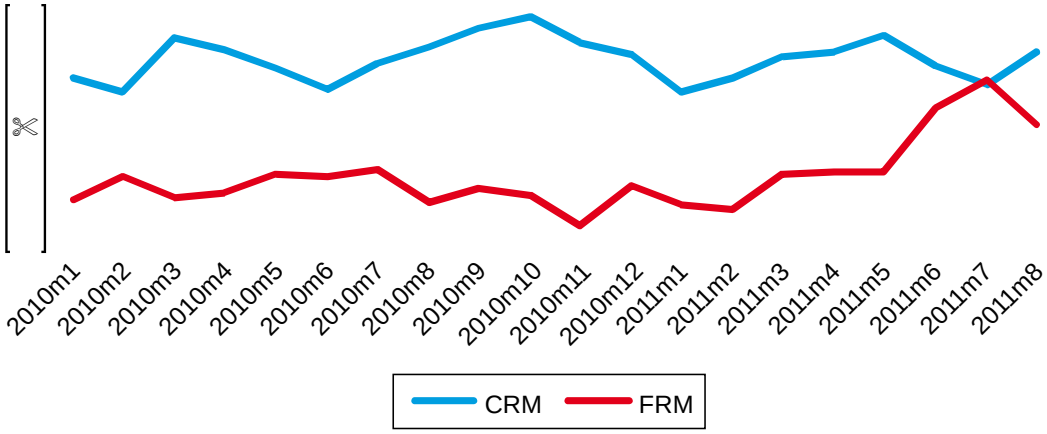


Source: CC analysis of Kerry's data.

8. From November 2010, Customer 1's net prices of FRM and CRM had a tendency to converge slowly but diverged since July 2011.

FIGURE 6

Customer 3 unit net price

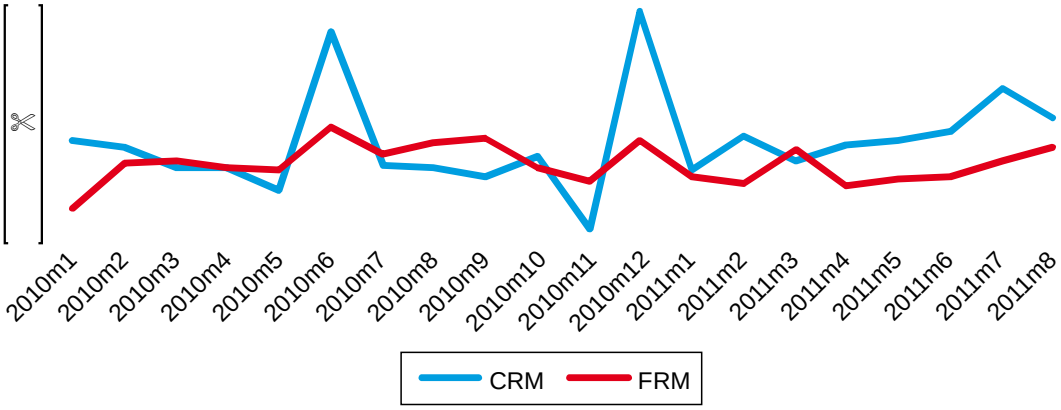


Source: CC analysis of Kerry's data.

9. The FRM and CRM net prices charged to Customer 3 moved in parallel up to May 2011 and then began to fluctuate.

FIGURE 7

Customer 5 unit net price



Source: CC analysis of Kerry's data.

10. For Customer 5, except for two spikes of CRM's net price in 2010, the gap between CRM and FRM windened since March 2011.

Net price changes by FRM

TABLE 1 **List of products produced at Carrickmacross for which net price increased in August 2011 YTY**

Product	*Customer*	*Vol rank 2010*	*Type*	*Cuisine*	*Unit price 2010 c*	*Unit price 2011 c*	*Price diff c*	*Price increase %*	*Net price 2010 c*	*Net price 2011 c*	*Net price diff c*	*Net price increase %*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Kerry's data.

Note: High percentage net price changes are due to gross price changes; unit cost changes are relatively small.

TABLE 2 **List of products produced at Flint and Grimsby for which net price increased in August 2011 YTY**

Product	*Customer*	*Vol rank 2010*	*Type*	*Cuisine*	*Unit price 2010 p*	*Unit price 2011 p*	*Price diff p*	*Price increase %*	*Net price 2010 p*	*Net price 2011 p*	*Net price diff p*	*Net price increase %*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC analysis of Kerry's data and Headland's data (both supplied by Kerry).

Note: High percentage net price changes are due to gross price changes; unit cost changes are relatively small.

Spare capacity and imports

Introduction

1. This appendix sets out evidence relating to spare capacity among UK suppliers, and the use and potential use of importers.

Capacity

The measurement of capacity and Kerry's capacity

2. Kerry provided a detailed response to our queries on capacity. Kerry explained that there was no straightforward measurement of capacity available. While there is a nameplate capacity rating for the products that each production line can produce, this is not achievable in practice. Factors which affect the capacity of a line include:

   - The number of changeovers required in producing different products on the line. At its simplest a changeover may be achieved in [✂] minutes but may take up to [✂] hours if major changes are required such as pack size changes. If a line needs to be flushed through, for example because of allergen considerations or other contamination risks, the changeover can also take several hours. Most of the Kerry Carrickmacross lines have a number of changeovers each day. At the site visit Kerry told us that Headland procedures for cleaning had been overly rigorous and resulted in changeovers which were longer than needed in most cases.

   - There may be other bottlenecks in the system that slow the process down. There may be other equipment required in the process (for example, potato topping equipment at Grimsby or carbohydrate cooking and cooling equipment at Carrickmacross) or there may be products that require a particular hand finish or placement of products (Kerry gave the example that a three-shot meal produced fully automatically may operate at 130 packs per minute (ppm) but a six-shot meal on the same line that requires three shots to be delivered by hand would operate at 80 ppm).

   - There may also be outages (breakdowns) that reduce equipment availability.

3. In addition, overall availability of lines may not exactly match customer requirements (for example, there may be more boil-in-the-bag capacity than is needed at a particular time, so effective capacity will be further reduced).

4. To address these issues, Kerry calculated the number of shift hours required to produce its existing demand. It then compared this with the maximum hours available (working a five-day three-shifts-per-day shift system—total 116 hours per week) and thereby calculated the spare capacity. Kerry's calculations for Carrickmacross are shown in Table 1.

TABLE 1 **Carrickmacross capacity calculation***

Line	*Nameplate ppm*	*Forecast demand (units per week)*	*Hours to produce average demand (average per week)*	*Actual ppm*	*Actual ppm as a % of nameplate ppm*	*Maximum hours that could be worked (weekly; on current shift patterns)*	*Spare capacity (units)*
1	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
SL80	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
4	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
5	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
6	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total		[✂]					[✂]

Source: Kerry.

*Kerry said that this was adjusted for losses of [✂] volume.

5. Kerry therefore calculated that the capacity of its lines at Carrickmacross varied [up to 60–70] per cent of the nameplate capacity of the line. We note that in any event this may still be a high estimate of the capacity realistically available. As noted above, there is unlikely to be an exact match between the requirements of customers and the production capacities of the plant. There may also be reliability issues if the plant is worked to this extent. Using this methodology, Kerry calculated the capacity and spare capacity for Carrickmacross and Grimsby. The results are shown in Table 2.

TABLE 2 **Capacity availability**

Meals	*Capacity*	*Spare capacity*
Carrickmacross per week	[✂]	[✂]
Grimsby per week	[✂]	[✂]
Total per week	[✂]	[✂]
Total per year (48 weeks assumed)	[✂]	[✂]

Source: Kerry.

Capacity for other UK FRM producers

6. We looked at the capacity of other UK FRM producers. We set out here Kerry's evidence of its estimates of others' spare capacity, and then we consider evidence received from other suppliers themselves (from paragraph 11).

Kerry's estimates

7. Kerry provided the OFT with estimates of capacity and spare capacity for other players in the UK market. These are shown in Table 3. It estimated a total spare capacity of 205 million meals a year.

TABLE 3 **Kerry estimates of competitors' capacity**

Competitor	*Number of lines*	*Nameplate capacity (m meals pa)*	*Estimated capacity (m meals pa) (70% of nameplate)*	*Estimated spare capacity (m meals pa)*
Authentic Foods	[✂]	[✂]	[✂]	[✂]
Brown Brothers (Foodpro)	[✂]	[✂]	[✂]	[✂]
Loxton Foods	[✂]	[✂]	[✂]	[✂]
Longbenton Foods*	[✂]	[✂]	[✂]	[✂]
Heinz	[✂]	[✂]	[✂]	[✂]

Source: Kerry.

*This factory is closed.

8. We noted that Kerry was assuming the same shift pattern that it worked was worked at its competitors' facilities, which may not always be achievable or correct (for example, one supplier told us that its factory's location imposed restrictions on its operating hours). In addition, Kerry assumed a high utilization of capacity of 70 per cent, which it does not achieve on any of its own production lines. This might lead to its estimates being higher than actual capacity.

Other suppliers' estimates of capacity

9. We sought estimates of capacity and spare capacity from the suppliers identified by Kerry (see Table 3). We also sought estimates of spare capacity from two other FRM suppliers. Taking the spare capacity of all these suppliers together, we found a total spare capacity of around 90–100 million units per year.

10. Two parties told us that their spare capacity would be mostly or fully used up shortly with new business. One party also told us that it would not seek to compete at the value end of the market, and gave reasons why it would not do so. One party said that it had virtually no spare capacity. Three parties told us that they had some spare capacity. One of these parties, [✂], expressed some caveats on its use, and another supplier noted that there were reasons why spare capacity it had was not likely to be used by customers requiring large volumes of an FRM product. [✂]

11. By way of comparison, a large supermarket will typically sell hundreds of thousands of FRM per year, and can sell over 2 million units per year of a particularly popular frozen ready meal (Kerry told us that [✂] sold over 3 million units per year).

Comments from customers

12. We sought evidence from contract-pack customers and retailers.

13. Some customers we spoke to said that Kerry was the only supplier that had the capability and quality of product to provide them with value-range products (a point disputed by Kerry, which referred to actual switching of value-range meals after the merger). Customers generally found it difficult to find an alternative supplier for all the products produced by Kerry. As a result, customers had to look at using more than one supplier if they were interested in moving substantial portions of their business from Kerry. Customer comments (retailers and contract-packing customers) consistently suggested that none of the UK-based suppliers could compete in the value end of the market.

14. [More than one customer] we spoke to had identified alternative suppliers (in the UK and overseas) for some or all of their business that, before the merger, had been supplied by Kerry and/or Headland.

15. [More than one customer] we spoke to had been looking at possible alternative suppliers but had not yet been able to ascertain whether there were in fact credible alternatives to Kerry for their FRM requirements.

16. Overall, the evidence suggested to us that, whilst there were some caveats regarding the possible use of some capacity, there is spare capacity available for use by Kerry's customers among UK suppliers.

Additional capacity

17. Kerry told the OFT that it was not difficult or expensive to add new capacity; CRM suppliers suggested that a new FRM production line could be added for between £0.5 million and £1 million.

18. We spoke to other FRM suppliers which told us about the costs of installing lines. These lines were of varying sophistication, size and capacity. Their costs varied from £100,000 to over £2 million. Time frames for installation appeared to be around three to four months.

19. We found some, but very limited, appetite at current prices from customers to facilitate the creation of additional capacity through sharing costs or guaranteeing production.

Imports

Kerry's evidence

20. Kerry said that ready meals manufacturers in the rest of the EU and even further afield could and did compete effectively to supply FRM into the UK and it was immaterial whether the FRM were own label, contract packed or own brand. Kerry:

    - said that transportation costs were low. Kerry provided documentation on the cost of importing FRM from a number of countries to illustrate this point;
    - noted its own success as a euro-based supplier into the UK;
    - noted the presence in closely similar markets of very large-scale imports from mainland Europe;
    - said that substantial new entry from mainland Europe had occurred, including by Stefano Toselli of France; and
    - pointed to the recent launch in Morrisons of a range of FRM manufactured by CP Foods Thailand, including meals shipped complete from Thailand.

21. Kerry said that the costs of manufacturing FRM in the EU were comparable to those in the UK and Ireland. It said that the main differences would be likely to be labour and energy costs (particularly commodity-price-related raw material costs). Kerry also said that manufacturing costs in Thailand and other non-EU states might well be significantly lower, which might offset the greater transportation costs.

22. In terms of suppliers from abroad currently active in the UK, Kerry told the OFT that it had value and volume data for three importers: Crops ([✂]), CP Thailand ([✂]), Vion ([✂]), and Schwan ([✂]). Kerry told us that the first three of these were currently importers into the UK, with CP Thailand supplying Iceland in 2009 and 2010 (and now supplying a new line of FRM at Morrisons), Vion supplying Tesco from 2010 and Birds Eye in 2008 and 2009, and Crops supplying Tesco, Asda and Morrisons in at least 2011. It also noted that Stefano Toselli was importing over [✂] FRM for Iceland, and subsequently listed another two new importers.

23. Kerry collated a document which listed 38 actual or potential FRM suppliers on mainland Europe. Some of these appeared to be duplicate entries (for example, the same firm entered twice, once where it was headquartered and once where its factory was), and it was unclear from the evidence provided whether some were actually active in FRM as opposed to, for example, CRM or ambient ready meals. We noted that many suppliers on this list were not quoted by any UK customers to whom we spoke; however, a small number of additional names were cited by customers as suppliers that had been considered.

Evidence from importers

24. We spoke to five current importers. No importers currently supply a large number of product lines to any UK customer. All five importers told us that they had spare capacity for tray FRMs in varying degrees. Two told us that there were limitations on that capacity: one said that its production facility had limitations which restricted its attractiveness for UK customers and its facility was limited such that it could probably only produce value-end products; another said that it could not handle products which required a significant degree of manual intervention in the process.

25. One importer told us that it had won one line of business, previously supplied by Kerry, since the merger. Two importers told us that they had been contacted by some UK customers about potential supply, but discussions were at an early stage. One importer told us that it had not received much contact from potential UK customers since the merger. The other said that it had been contacted by potential UK customers since the merger but none of those contacts had led to business. It said that it could not compete at the value end for retail prices at £1, but could if retail prices were of the order of £1.20.

Evidence from other suppliers

26. UK-based suppliers generally did not consider imports to be a major threat:

- One acknowledged there was always the risk of imports but noted the weakness of the pound. It also said that when buying from countries further afield, such as Thailand, the nature of the commitment would be likely to be long term and it would then be hard to respond to market changes. It acknowledged that transport would not be such an issue from Europe but noted that in its product area there were not many companies that could produce the required quality of Asian product. It suggested that Kerry was able to import because of the element of critical mass there due to the big factories that they were operating in the Republic of Ireland and noted that transport costs from the Republic of Ireland were not very large.

- One suggested that there were some additional logistics issues associated with importing from Europe.

- One said that it was aware of limited imports into the UK but that they did not have a material impact on the UK FRM market.

Comments from customers

27. Several customers told us that they had considered imports from Europe, indeed several had already used importers for a small number of FRM before the merger. Some mentioned technical considerations which they felt ruled out some importers they had been in contact with. In terms of looking for alternative providers since the merger:

- One customer told us that it had used overseas FRM providers before, and found that they had the required technology, and with a favourable exchange rate at the time sourcing from these suppliers had been a viable option. It said that it had revisited this issue in the light of the Kerry price increase and found that transport costs, currency fluctuations and taste profiles were issues for possible importers.

- Two customers said that they had identified more than one importer to whom they could move some of the business they had with Kerry.

- Two other customers told us that they were planning to move part of their business from Kerry to an importer.

- One customer said that it had not previously used European suppliers but had identified two potential suppliers, and it was in the early stages of assessing whether either would be a suitable supplier. It said that it was too early to say whether it would be able to use either supplier.

- One customer said that it currently used an importer and had recently had some discussions with some alternative suppliers, but this was at an early stage.

- One customer said that European sourcing was a longer-term option it was progressing as the competitive set had reduced in the UK. It said that there were barriers but that in the longer term the barriers were not insurmountable. It also mentioned the logistics issues as problematic (in terms of reaction times where products were promoted and supply complexities due to distance).

- One customer had been in contact with some overseas suppliers but had not found suitable ones yet.

- One customer said that it was looking to see if there were alternative UK suppliers before considering European suppliers.

- One customer said that it was not, at this time, cost or resource effective to try and source product from abroad.

Assessment

28. The main themes concerning imports appear to be: whether the costs overall are too high, exchange rates, taste and some retailer-specific technical issues.

Cost issues

29. A number of customers considered that the cost of importing was high. We have examined the two main cost differences which may arise—transport costs and local labour costs.

Transport costs

30. Kerry and various other parties incurred transport costs for importing FRM into the UK from a number of locations. The transport costs from Kerry were generally somewhat lower than the other estimates. Estimates from customers and suppliers suggested that transport costs from France and Belgium were of the order of 4p to 5p per unit, and further afield in Western Europe 7p to 10p per unit.

31. The differences in cost suggest that transport from close parts of Europe such as Belgium, north-west France, north-west Germany and the Netherlands would not be prohibitively expensive compared with transporting from within the UK. Transport from further afield appears less attractive unless there are significant cost savings in production—though we noted that one such supplier has won some business since the merger, suggesting that imports from across Western Europe are feasible.

32. Transport costs for locations such as Thailand also need to be offset by significant cost savings in production (we were told that labour and raw material costs were much lower there, offsetting transportation costs). The comments from some retailers also focused on the logistics issues of sourcing from Europe, particularly in relation to demand fluctuations that may arise, eg as a result of a promotion. However, although these factors may be a particular issue where the supply chain is very long, it is difficult to see why these should be a major factor for imports from areas close to the UK.

33. Some customers referred to logistics difficulties where FRM are imported, with a longer supply chain than UK distribution. The difficulties of managing a long supply chain are likely to be a significant issue for transport from further away (such as Thailand or Eastern Europe). However, we do not see why this should be a substantial issue for deliveries from near European countries and do not see a substantial difference for these countries compared with deliveries from the Republic of Ireland or from UK locations.

Labour costs

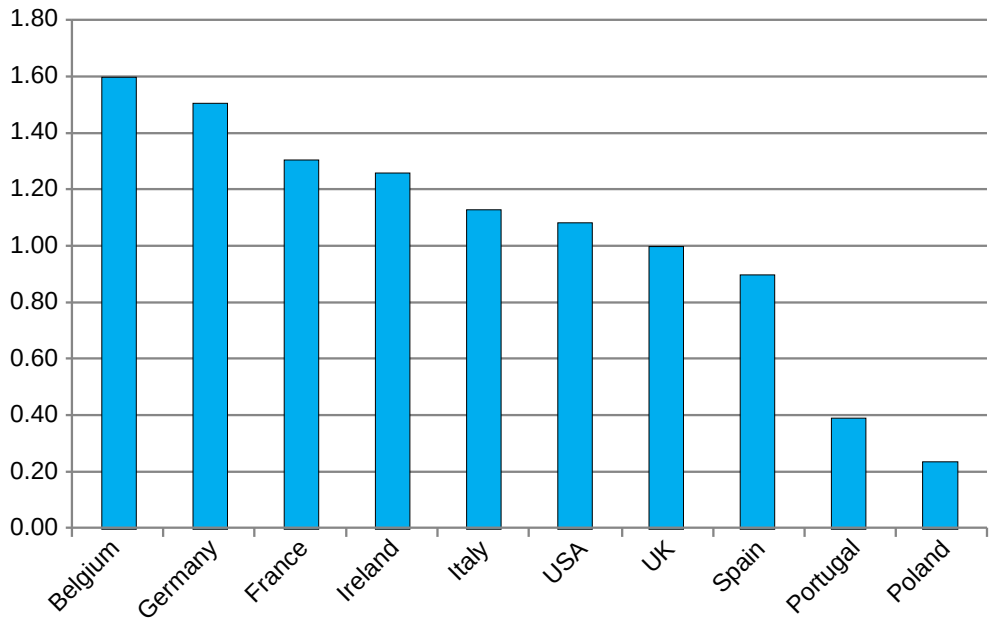
34. Kerry provided figures that showed that its raw materials and packaging costs amounted to [✂] per cent of revenue in 2011 year to date to June ([✂] per cent in 2010). Kerry said that raw materials costs were commodity price related and there was little difference in these costs across countries. Labour costs appear to be the most significant cost that varies across countries. Figures from Kerry showed that its Carrickmacross and Grimsby plants have labour costs that amount to some [✂] per cent of revenue.

35. Figure 1 shows manufacturing compensation rates for various European countries. Germany and Belgium are particularly high. However, the Republic of Ireland and France are also high in relation to the UK. The high costs for Belgium may be part of the reason why a number of retailers had found that importing from Belgium was unattractive. As an illustration, if labour costs in the Republic of Ireland were, say, 10 per cent of unit price, then on a like-for-like basis the overall cost of the FRM from Belgium would be around 2 per cent higher than the cost from the Republic of

Ireland, which in turn would be around 2 per cent more expensive than from the UK (Poland would be 7 to 8 per cent less expensive than the UK). However, even though labour costs in the Republic of Ireland are higher than in the UK, Kerry still appears able to compete in the UK FRM market.

FIGURE 1

Relative manufacturing compensation costs in selected countries for 2009 (UK = 1)



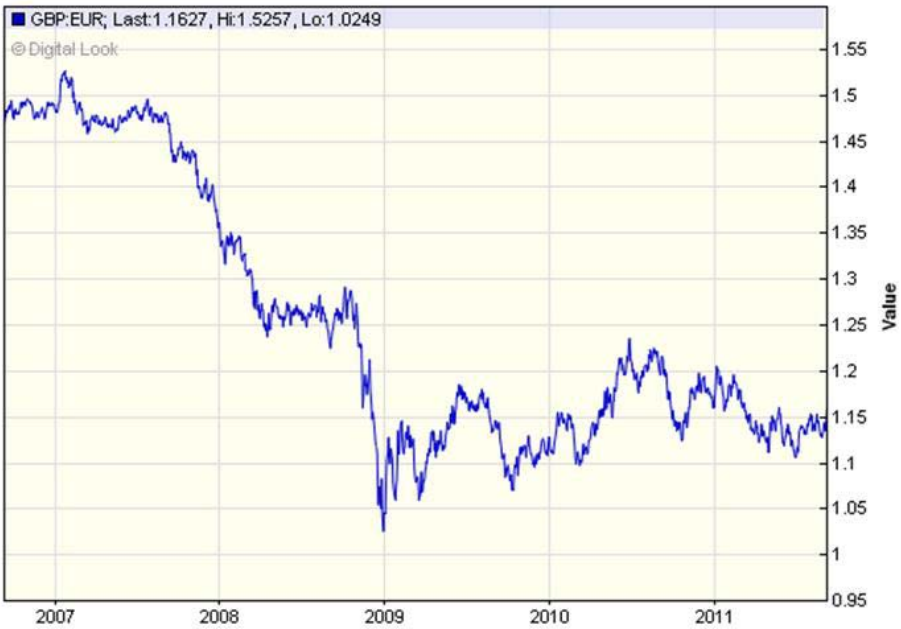
Source: Bureau of Labor Statistics, US Dept of Labor, March 2011.

Exchange rates

36. A second factor raised by third parties that may make imports less attractive was exchange movements. The euro–sterling exchange rate has moved significantly in the last five years and would have affected the cost of imports. However, as noted in paragraph 37, a significant proportion of costs are raw materials costs which are commodity price related. This should allow this proportion of the manufacturing cost to be hedged in the event of exchange rate movements. We also note that Kerry has continued to import successfully value FRMs over the period.

FIGURE 2

Fluctuations in sterling/euro exchange rate, 2007 to 2011



Source: www.digitallook.com/cgi-bin/dlmedia/fx_rates.

Taste

37. The third factor raised was taste differences between countries. Some customers, including retailers, suggested that this was an issue that made imports unattractive. However, there appeared to be solutions to this issue. Customers' views are set out below:

- One customer said that it had identified firms based in Europe that had UK management teams or UK chefs. On the other hand, it was not looking to do further business with one importer because of concerns over its ability to match UK flavours.

- One customer cited taste profiles as an issue that caused difficulties in using overseas suppliers. It said that there were a number of issues which, whilst they did not make overseas supply impossible, made it more difficult and complex. It said that countries had different tastes and that whilst suppliers could be given detailed specifications, due to the different ways businesses set up their process lines, there was still a requirement for a company to be able to modify or adapt a recipe or process to achieve a correct taste profile. Suppliers were required to taste the dish at regular intervals, which could be difficult if the operators were not familiar with the dish.

- One customer said that there was extensive work needed with European suppliers as some of what they usually made was unacceptable to the UK palate.

- One customer said that it had had a discussion with an importer but had quickly ruled it out from a taste point of view.

38. One importer said that the ability to match taste depended not only on ingredients but when ingredients were added to the recipe and how the product was cooked, and these factors were not specified by the customer.

39. Given the detail of the recipe specification, which typically includes where raw materials should be sourced from, it seems unlikely that it is not possible to replicate a recipe to UK taste overseas—and indeed the number of products being imported suggests that this is not an insurmountable barrier.

40. Three importers we spoke to told us that they had development chefs who were either British or had significant experience of the UK market, in order to overcome issues about matching UK taste.

Customer-specific technical issues

41. A number of customers referred to particular technical issues that they had encountered when evaluating possible suppliers. Two customers raised issues about the same importer's ability to provide much, or any, of their needs.

Evidence on supplier switching

[✂]

Glossary

Act	Enterprise Act 2002.
Aldi	Aldi Stores Ltd.
Asda	Asda Stores Limited.
Birds Eye	Birds Eye Limited.
BOP	Business operating profit.
Carrickmacross	Location of **Kerry**'s **FRM** manufacturing facility in the Republic of Ireland.
Chamonix	Chamonix Private Equity. Private equity firm and owner of **Headland** at the time of the merger.
CRM	Chilled ready meals.
CC	Competition Commission.
Contract packed	Contract-packed **FRM** is an arrangement where an **FRM** supplier contracts to manufacture **FRM** for a third party that sells it under its own brand name.
Co-op	Co-operative Group Limited.
EBITDA	Earnings before interest, tax, depreciation and amortization; a measure of profitability.
Ferndale Foods	Ferndale Foods, a manufacturer of **FRM**.
Findus	Findus Group.
Flint factory	Headland-owned FRM production facility that was closed in April 2011.
FRM	Frozen ready meals. Main course meals which only require heating before being ready to eat.
Grimsby factory	FRM production facility, the ownership of which switched from Headland to Kerry following the merger.
Headland	Headland Foods Ltd. A former manufacturer of **FRM**.
Heinz	H J Heinz Company Limited, producer of **own-brand FRM**.
Iceland	Iceland Foods Ltd.
Kerry	Kerry Foods Limited. Kerry is part of the Kerry Group plc, a company registered in the Republic of Ireland.
Lidl	Lidl UK GmbH.

Longbenton Foods	Longbenton Foods, a manufacturer of **FRM.**
Marlow Foods	Marlow Foods Ltd, manufacturer of **FRM** branded as Quorn.
Mintel	Mintel Group Limited. A market and product research company.
Morrisons	Wm Morrison Supermarkets plc.
OFT	Office of Fair Trading.
Operating profit	A measure of profitability; in this inquiry defined as turnover less prime costs less overheads.
Own-brand	Own-brand **FRM** are sold under the brand name of the **FRM** manufacturer.
Own-label	Own-label **FRM** are manufactured by **FRM** suppliers for supermarkets, and are sold under the supermarket's brand.
p-value	The smallest significance level at which the null hypothesis of a statistical test can be rejected. Equivalently, the largest significance level at which the null hypothesis cannot be rejected.
Prime costs	Cost of goods sold; in this inquiry comprising raw materials and direct labour.
Quorn	Quorn Foods, owned by **Marlow Foods Ltd**.
Sainsbury's	J Sainsbury plc.
Significance level	The probability of rejecting the null hypothesis of a statistical test when it is true (ie the probability of committing a Type I error).
SLC	Substantial lessening of competition.
t-test	The t-test used here is a statistical test of the equality of means of two groups or two samples of data.
Tesco	Tesco plc.
Vion Foods	VION Food Group Ltd, the UK arm of VION NV.