COMPETITION COMMISSION

# Kerry Foods Limited/Headland Foods Limited merger inquiry

A report on the completed acquisition by Kerry Foods Limited of the frozen ready meals business of Headland Foods Limited

**2 December 2011**

## Members of the Competition Commission who conducted this inquiry

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The Competition Commission has excluded from this published version of the report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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# Summary


1. On 12 July 2011 the Office of Fair Trading (OFT) referred the completed acquisition of the frozen ready meals (FRM) business of Headland Foods Limited (Headland) by Kerry Foods Limited (Kerry) to the CC for investigation and report.

2. Kerry is part of the Consumer Foods division of Kerry Group plc, a company registered in the Republic of Ireland that manufactures foods and food ingredients and had sales of around €5 billion in 2010. Headland is a company registered in England and Wales whose major shareholder is Chamonix Private Equity (Chamonix). Prior to the acquisition both Kerry and Headland manufactured FRM, Kerry at a factory at Carrickmacross in the Republic of Ireland, and Headland at factories in Flint and Grimsby. They were the two largest suppliers of FRM to UK customers (typically retailers—generally supermarkets—or brand owners).

3. On 14 January 2011 Kerry acquired Headland's FRM business. We concluded that the acquisition by Kerry of the FRM business resulted in the creation of a relevant merger situation.

4. We concluded that the relevant market in which to assess the effects of the merger was the supply of FRM manufactured in the UK and Republic of Ireland for customers in the UK.

5. At the time the merger was agreed, Headland was conducting a statutory consultation on closing the Flint factory. The Flint factory was closed in April 2011 and Kerry transferred the manufacturing of the products previously made there to either Carrickmacross or Grimsby. We concluded that, in the absence of the merger, Headland would have been likely to consolidate its operations at its Grimsby factory and would have continued to supply the full range of FRM, in competition with Kerry, for the foreseeable future. We decided that the alternative scenario, put forward by Kerry, that the restructuring plan would not have been successful and Headland would have exited the market, was less likely than the counterfactual scenario that we used.

6. We concluded that, before the merger, Kerry and Headland were each other's closest competitors. We also found that, at that time, customers had no significant incentive to find alternative suppliers to the merging parties. The merger reduced the number of significant competitors supplying FRM in the UK and provided customers with an incentive to seek alternative suppliers.

7. Following the merger, Kerry sought and, at least initially, achieved significant price increases from many of its customers. In particular, we found that the price rises achieved in summer 2011 were in many instances significantly greater than the rise in input costs over the preceding 12 months and that Kerry was able, at least in the short term, to increase its margins on FRM.

8. As this merger was referred to us as a completed transaction, we were able to observe the events unfolding and noted that with time and effort, and in at least one case some cost, many customers have been able to find alternative suppliers for products covering the range of FRM. We saw no reason to believe that those who have not yet switched are substantially different from those who have found alternative suppliers. Moreover, the prices customers are paying after switching are either comparable to pre-merger prices or are higher only to an extent that could be explained by increases in raw materials costs.

9. We therefore concluded that the merger only allowed Kerry to impose price increases on a large share of the FRM volume in the short term.

10. We found that customers have sufficient alternative providers in the UK and overseas to be able to switch away from Kerry, or threaten to do so, such that Kerry will be constrained from imposing prices which exceed pre-merger levels by substantially more than by increases in cost. Therefore, Kerry's ability to charge higher prices as a result of the merger is unlikely to persist beyond the short term.

11. We concluded that the merger did not and was not expected to result in a substantial lessening of competition (SLC) in any market or markets in the UK for goods or services.

# Findings

## 1. The reference

1.1 On 12 July 2011 the OFT referred the completed acquisition of the FRM business of Headland by Kerry to the CC for investigation and report. The reference was made under section 22(1) of the Enterprise Act 2002 (the Act). The reference requires us to determine:

*(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 an SLC within any market or markets in the UK for goods or services.[1]

1.2 We are required to publish our final report by 26 December 2011. Our terms of reference, together with information on the conduct of the inquiry, are set out in Appendix A.

1.3 This document, together with its appendices, constitutes our report in respect of the reference which we are required to publish under section 38(1) of the Act. Further information, including non-commercially-sensitive versions of Kerry's submission, summaries of evidence from third parties and our provisional findings can be found on our website.[2]

## 2. Frozen ready meals

2.1 FRM are frozen main course dishes which only require heating before being ready to eat. FRM typically cover a range of types of main meals, including traditional British, Chinese, Indian and Italian. Kerry told us that in 2010 around 372 million FRM were sold in the UK.

2.2 FRM are manufactured on production lines, which are often highly automated and which can produce anything up to 200 products per minute. These are similar to lines used for the production of chilled ready meals (CRM) but FRM production lines (and in particular those for value-range products) operate at faster speeds and in longer production runs than CRM lines. FRM production lines also need a freezing unit to freeze the ready meal prior to storage and distribution.

### *Types of FRM*

2.3 FRM can be divided into three main types: own label, own brand and contract packed.

2.4 Own-label FRM are produced by FRM manufacturers for retailers and sold under the retailer's brand (for example, Sainsbury's beef lasagne is an own-label product manufactured by Kerry for Sainsbury's). Most own-label FRM are sold by the major supermarkets. Own-label products can be further subdivided by the price points at which they are sold:

*(a)* A small number of own-label FRM are sold to consumers for less than £1 (Tesco had two and Asda one).

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[1] Enterprise Act 2002, section 35.
[2] www.competition-commission.org.uk/inquiries/ref2011/kerry_headland/index.htm.

*(b)* The bulk of own-label FRM sales are products which were sold to consumers before the merger at £1 each; after the merger the price at the four major supermarkets for these increased to £1.30. These products are often sold on multi-buy offers. This is often referred to as the value range.

*(c)* There is a mid-tier range, with products sold at a price point around £1.80 (£1.50 before the merger).

*(d)* There are some FRM sold to consumers between £2 and £3 but not all supermarkets offer a premium FRM range.[3]

2.5 Own-brand FRM are produced by FRM manufacturers and sold by retailers under the manufacturer's brand name (for example, Heinz makes its own FRM which it sells under the Weight Watchers brand). Most own-brand FRM are sold at higher price points (£1.80 and above), though some are sold at value-range prices (for example, Heinz's Ross brand FRM are sold in convenience stores with a recommended retail price of £1.29[4]).

2.6 Contract packed FRM are produced by FRM manufacturers and sold under a third party brand name (for example, Kerry manufactures FRM for Birds Eye which are sold under the Birds Eye brand). These FRM usually retail at slightly higher prices than own-brand FRM.

2.7 Retailers and consumers are unlikely in practice to see a difference between own-brand and contract-packed FRM as both are FRM products sold under a brand name which is not that of the shop in which it is sold. Different retailers stock differing proportions of branded and own-label products; evidence from Kerry showed that in 2010 Iceland stocked 75 per cent by value of own-label FRM and 25 per cent branded FRM, whereas Sainsbury's and Morrisons stocked around 40 per cent own-label FRM and 60 per cent branded FRM.

### *FRM and CRM*

2.8 Sales of CRM are far greater than those of FRM. Mintel reported that over the period 2005 to 2010 CRM saw a 15 per cent growth to sales of £2.3 billion, whereas FRM sales declined by 22 per cent to £437 million.

2.9 We were told that there were significant differences between FRM and CRM, in terms of who purchases them, what people think of them, why they are purchased, and how much they cost. One retailer told us that customers perceive CRM to be better, and Aldi said that there was a perceived difference in quality and freshness. We were also told that the two products were seen as fulfilling different roles by the consumer, and were sold in different parts of a supermarket. Research conducted for Kerry found that FRM were seen by consumers as a 'poor relative' to CRM, with FRM purchased for 'functional' purposes whilst CRM were seen more as an 'emotional' purchase.

2.10 We were told that the demographic profile of customers who bought FRM and CRM were different.[5] Sainsbury's told us that FRM sales were predominantly to 'Retirees/

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[3] Tesco does not offer a Finest FRM range (Summary of a conference call with Tesco, paragraph 2,) nor does Sainsbury's offer Taste the Difference FRM products.
[4] Summary of a hearing with Heinz, paragraph 1.
[5] We were also told that most consumers who bought ready meals purchased both FRM and CRM. Kerry told us that over 90 per cent of FRM consumers also bought CRM (Kerry main submission, Annex A, paragraph 10). Sainsbury's told us that many consumer baskets would include a blend of FRM and CRM.

Low affluent'; CRM sales were predominantly from the 'Younger/affluent' category. Mintel reported that the demographic profile of customers suggested that CRM were a convenience food carrying a price premium, whilst FRM were value-driven purchases.[6]

2.11 We were told that CRM were usually more expensive than FRM. One retailer said that the perception that CRM were better meant that customers would pay more for them and that at higher price points customers would move from FRM into CRM. Kerry said that FRM and CRM might be priced similarly at the value end of the market.

## 3. The companies

### *Kerry*

3.1 Kerry, a company registered in England and Wales and whose business includes Meal Solutions, is part of the Consumer Foods division of Kerry Group plc, a company registered in the Republic of Ireland that manufactures foods and food ingredients. Kerry Group plc had sales of around €5 billion in 2010. The Meal Solutions Business manufactures chilled, frozen and ready-to-cook meals under supermarkets' own labels, other third party brands as well as its own brands.

3.2 Prior to the acquisition, the Meal Solutions division manufactured all its products across five sites in the UK and the Republic of Ireland, one of which, located in Carrickmacross, manufactured FRM. All the other factories manufactured chilled and ready-to-cook ready meals, although some also produced a limited number of FRM around five years ago.

### *Headland*

3.3 Headland's major shareholder, Chamonix Private Equity (Chamonix), acquired its interest in Headland in 2006 from 3i as part of a portfolio of assets. Headland manufactured own-label and contract-packed FRM as well as FRM for the food service and airline sector. It had two factories, one located in Flint, north-east Wales, the other in Grimsby, Lincolnshire. Its turnover in the UK in 2010 was around £67 million.

## 4. The completed merger and the relevant merger situation

### *Outline of merger situation*

4.1 On 14 January 2011, Kerry acquired Headland's FRM business.[7] This included the freehold to, and equipment in, Headland's Grimsby factory, the equipment in Headland's Flint factory (but not the factory itself), stock, the benefit of Headland's contracts, the information and IT systems relating to the business and any claims against third parties relating to the business. Some of the business's key employees also transferred to Kerry.

4.2 At the time the merger was agreed (20 December 2010), Headland was conducting a statutory consultation on closing the Flint factory and moving production to Grimsby;

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[6] *Mintel Chilled and Frozen Ready Meals Market Intelligence*, May 2010, p6.

[7] Since the transaction did not involve the acquisition of shares in Headland, Chamonix still owns the majority of Headland shares.

Kerry continued with the consultation and the Flint factory, still owned by Headland, was closed in April 2011. Kerry moved some production from the Flint factory to Grimsby and some to its factory at Carrickmacross.

### *The rationale for the merger*

4.3 An August 2010 Kerry internal document considering the possible merger set out the 'strategic rationale' for the merger as follows:

- FRM has declined which has created excess capacity;
- There is excess manufacturing capacity. Kerry Foods and Headland each have about 25% market share and are continually played off [against] each other by retailers, driving prices down;
- Closing one of Headland's sites and investing in some more efficient processes at the other would give, with [Carrickmacross] a highly efficient operation;
- Combining the businesses would facilitate acceptable margins returning to the category.

4.4 A Kerry internal document produced during the due diligence phase of the acquisition noted that 'the success of the acquisition (i.e. delivering an annualised [✂]% BOP by 2012) is dependent on the delivery of significant price increases across all customers (>[✂]% average) without loss of current volumes and £[✂]m of synergies'.[8]

4.5 Kerry submitted to the OFT that the rationale for the merger rested on two factors: that Headland was a failing firm which inevitably would have exited the market in the absence of a merger, and Kerry was the only buyer for the assets; and the merger would deliver significant synergies, in the form of cost savings through Kerry's ownership of both the Carrickmacross and Grimsby factories.

4.6 Kerry told us that, by acquiring the FRM business of Headland, it avoided the 'real risk of serious supply disruptions caused by Headland's imminent exit (whether through failure or withdrawing from the core FRM manufacturing business)'; in effect Kerry was assuming that Headland would exit the market and its customers would move to Kerry. It also said that the 'OFT accepted that the need to avoid this disruption explained Kerry's willingness to pay £[✂] million for Headland's FRM business (including stock valued at £[✂] million)'.[9] Whilst Kerry did not tell us explicitly that it was a rationale for the merger, it said that the price it paid for the business (minus the stock) was less than the book value of the Grimsby factory alone.

### *Jurisdiction*

4.7 Under section 22 of the Act, and pursuant to our terms of reference (see Appendix A), the first statutory question we are required to answer is whether a relevant merger situation has been created. Section 23 of the Act provides that a relevant merger situation is created if two or more enterprises have ceased to be distinct

[8] Financial Due Diligence Report for Project Trinity, 8 December 2010, p2.
[9] Kerry submission, paragraph 17.

within the statutory period for reference and either the share of supply test or the turnover test specified in the Act is satisfied.

4.8 Kerry and the FRM business of Headland were both producers of FRM for gain or reward and accordingly we are satisfied that both were enterprises for the purposes of the Act (section 129).

4.9 The transaction as set out in paragraph 4.1 was completed on 14 January 2011 and was first made public on 28 January. We are satisfied that as a result of the transaction Kerry and the FRM business of Headland ceased to be distinct enterprises. The OFT's statutory deadline for reference was extended under section 25(1) and (2) of the Act to 25 July. The reference to the CC was made on 12 July, and we are therefore satisfied that Kerry and Headland ceased to be distinct enterprises as required by section 24 of the Act.

4.10 Under section 23 of the Act, the share of supply test is met if, as a result of the merger, the enterprises which ceased to be distinct have a share of supply of goods or services of any description in the UK, or in a substantial part of the UK of at least one-quarter. If one of the enterprises already supplied at least one-quarter, it must have increased its share as a result of the merger.[10]

4.11 Kerry and Headland were both active in the supply of FRM in the UK. We found that in 2010, Kerry supplied [20–30] per cent of FRM in the UK and Headland supplied [20–30] per cent of FRM in the UK. As a result of the transaction described in paragraph 4.1, Kerry increased its share of supply of FRM. We concluded that the merger satisfied the share of supply test.

4.12 We conclude that the acquisition by Kerry of the FRM business of Headland resulted in the creation of a relevant merger situation.

## 5. Market definition

5.1 The CC's merger assessment guidelines[11] (the Guidelines) state that the purpose of market definition is to provide a framework for the analysis of the competitive effects of the merger. The Guidelines go on to state that the CC and OFT will identify the market within which the merger may give rise to an SLC, and that this will include the most relevant constraints on behaviour of the merger firms.

5.2 The Guidelines also note that in practice, the analysis leading to the identification of the market or markets and assessment of competitive effects will overlap, with many of the factors affecting market definition being relevant to the assessment of competitive effects and vice versa.[12] In this section, we set out the relevant market in which we assessed the effects of the merger and note where we have dealt with some issues raised by the main parties in the context of market definition in our competitive assessment.

5.3 We concluded that an appropriate relevant market in which to assess the effects of the merger was the supply of FRM manufactured in the UK and Republic of Ireland for customers in the UK. Our conclusion was based on the observation that *(a)* the parties overlapped in this market (both supplied own-label and contract-packed FRM

[10] The application of the share of supply test is different from the identification of economic markets undertaken as part of any analysis of competition within an economic market. See *Merger assessment guidelines, CC2 (revised)*, September 2010 (the Guidelines), section 3.3.
[11] The Guidelines, paragraph 5.2.1.
[12] The Guidelines, paragraph 5.1.1.

to customers in the UK),[13] *(b)* the most direct competition faced by one supplier of FRM comes from other suppliers of FRM (including own-brand FRM manufacturers) and *(c)* this definition provided an appropriate basis for evaluating all constraints on the merged firm's conduct—the constraints arising within and between product segments inside the market, as well as other relevant constraints from outside the market including those outside the geographic market.

5.4 We used the relevant market of FRM to consider: *(a)* the constraints from different product segments within this market (own-brand, own-label and contract-packed FRM); and *(b)* the constraints from products not included in the market, especially CRM and imported FRM.

5.5 We found the geographic market to be the UK. We decided this on evidence from the majority of third parties who submitted that contracts were generally nationwide and at the time of the merger, Kerry and Heinz (from its factory at Dundalk in the Republic of Ireland) were the only importers with significant sales to UK customers. Kerry told us that 'actual and potential supplies by non-UK and Ireland operators imposed at least an important competitive constraint on manufacturers supplying FRM to UK customers (especially as FRMs are not perishable)'.[14] We consider the constraint imposed by imports in our assessment of the competitive effects of the merger, from paragraph 7.33.

### *Segmentation and aggregation*

5.6 The parties supplied bespoke own-label FRM and contract-packed FRM which were not substitutes on the demand side for those supplied to other customers. However, we decided that it was appropriate to aggregate these contracts into the same market or segment to the extent that any of the suppliers would be a credible bidder and could produce any of the bespoke products (supply-side substitution).

5.7 We took the view that we should treat all FRM contracts as belonging to the same market, and recognize any significant differences in the set of viable suppliers of different FRM products by identifying separate segments within that market. This approach allowed us to take into account any differences in the degree of competitive constraint between product groups in our assessment of the competitive effects of the merger. In our analysis we looked at subsets of FRM, by type of FRM (see paragraphs 2.3 to 2.6), price of FRM, and type of cuisine.

### *Constraints from products which are not in the market*

5.8 The parties said that they were constrained in providing FRM by suppliers of other categories of prepared food, including CRM and frozen foods other than ready meals, such as frozen fish or desserts. In Kerry's initial submission to us, it said that CRM were part of the relevant market.[15] Since defining the relevant market as FRM does not preclude consideration of the importance of constraints from products outside the market, we did not find it necessary to widen the market. Instead we consider the constraint imposed by CRM in our assessment of the competitive effects of the merger (see Section 7).

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[13] Kerry also supplies own-brand FRM and CRM. However, Headland did not and we do not consider there to be an overlap in this product category.
[14] Kerry's submission, Annex A, paragraph 17.
[15] See Kerry's initial submission, section B i).

5.9 We were content that we had identified and considered all relevant competitive constraints in our competitive assessment. We conclude that it is not necessary to identify a specific subset of the competitive constraints which would form a market that would satisfy the hypothetical monopolist test as no reasonable alternative market definition would have led to a different conclusion regarding the substantive effects of the merger.

## 6. Counterfactual

6.1 We considered what would have happened in the absence of the merger (the counterfactual).[16] Our evidence and analysis is set out in Appendix B. We summarize our findings here.

6.2 Kerry told us that Headland was a failing firm and that therefore the appropriate counterfactual was not the state of competition before the merger but Headland's inevitable exit from the market shortly after the date of the merger.

6.3 Kerry submitted that Headland was not operating a sustainable business: it was persistently and seriously loss-making, and was pricing at an unsustainable level in order to win or hold on to mostly loss-making business. It submitted that successive plans by its private equity owner, Chamonix, had failed, and it was dependent on cash injections from it; the closure of the Flint factory and relocation to Grimsby was, at the time of the merger, highly unlikely to have succeeded without further substantial investment. It submitted that there was no reason to believe that Headland's venture capital owners, had they been told that Kerry was not interested in purchasing Headland, would have continued to operate that entity as a substantial FRM manufacturer for any significant further period.

6.4 Chamonix told us that it had decided to restructure the Headland business, in particular by closing the Flint factory and moving all production to Grimsby. It said that it had a detailed plan for this, and the finances to carry out the restructuring. Longer term, Chamonix said that it had plans to diversify the business, but that FRM would remain central to Headland's business for at least the next few years; and that, provided the restructuring plans enabled Headland to break even (or better), a further attempt to identify alternative buyers for Headland might also have been made.

6.5 We conclude that, in the absence of the merger, Headland would have carried out a two-part restructuring plan to consolidate its operations at its Grimsby factory and reduce its indebtedness. This plan was supported by its shareholders and management. We expected this to return the business at least to break even and possibly to profitability because of a reduction in overheads, and would have improved the balance sheet.

6.6 We did not find Headland to be an exiting firm. We were satisfied it had sufficient cash/funding facilities to continue trading for the foreseeable future and to complete its two-part restructuring plan.

6.7 We found that Headland would have continued to supply FRM to retail/brand customers at all price points (value, mid-tier and premium) for at least the foreseeable future. Owing to anticipated cost inflation and continued pressure on prices from its core retail/brand customers, it is possible that Headland's profitability would have reduced over a two- to three-year period following the restructuring.

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[16] The Guidelines, paragraph 4.3.1, states: 'The application of the SLC test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger. The latter is called the "counterfactual".'

6.8 Chamonix outlined its expectations for the Headland business following the implementation of the two-part restructuring plan. We found that Chamonix may have explored opportunities to diversify the trading activity of Headland away from FRM. Headland planned to expand further into airline and food service, as well as focusing on certain product groups (eg pasta meals) and new areas (eg Europe). However, in our view this was not a core area for Headland which we concluded would have remained the manufacture and supply of FRM to UK retail/brand customers.

6.9 We also found that Chamonix may have considered other buyers for Headland. As a private equity firm whose investors ultimately require an exit so that funds can be realized, we formed the view that Chamonix would have sold Headland at some point, but not until it had implemented the restructuring plan. Although Chamonix had a time frame over which it would ideally exit an investment (which we understand from Chamonix to be between five and seven years from purchase), we believe that it would not have been dogmatic about exiting within a rigid time frame, because it was in its interest to realize the maximum possible price. We would expect there to be a wider set of potential buyers for a restructured, improved Headland than there were at the time of the sale to Kerry.

6.10 The Guidelines state that the counterfactual incorporates only those elements of scenarios that are foreseeable, enabling us to predict the counterfactual with confidence. In our view, in this case it is hard to predict events with any degree of certainty after more than two years, and we cannot predict how events would have unfolded after this time. The observations in paragraphs 6.8 and 6.9 are, in our view, conditional on uncertain events, and we could not form an expectation that these would happen in the foreseeable future. For these reasons, we do not include them in the counterfactual.

6.11 We therefore used the scenario of Headland competing in FRM from its Grimsby factory against Kerry as the situation against which to consider the effects of the merger. We recognized that there were other possible counterfactual scenarios, and noted that Kerry disagreed with our assessment of the counterfactual (see paragraphs 6.2 and 6.3).

6.12 We acknowledge that Headland's financial performance had been poor and that delivering the two-part restructuring plan to time and to budget carried significant risk. However, we noted that the plan was detailed, accurately costed and well considered; we accepted Chamonix's submission that there was sufficient cash and financing to carry out the plan, which would have led to a reduction in Headland's overheads and either to break-even or profitability. We also noted that [✂] Headland had been in negotiation with [✂] regarding a tender; [✂].

6.13 For these reasons, we decided that Kerry's assessment of the counterfactual was less likely than the counterfactual scenario we used. In any case, our findings on the statutory questions did not turn on the counterfactual used.

6.14 We conclude that, in the absence of the merger, Headland would have been likely to consolidate its production operations at its Grimsby factory and continued to supply FRM in competition with Kerry for the foreseeable future.

## 7. Assessment of the competitive effects of the merger

7.1 We considered the effects of the merger against the competitive situation in the absence of the merger, where we expected Kerry and Headland to be competing

against each other (the counterfactual) (see Section 6). As set out in our issues statement,[17] the merger could give rise to an SLC or the expectation of an SLC through the loss of competition in the supply of FRM. As this was a completed merger, we had the opportunity to observe the actual effects of the merger, including customers' responses, albeit only those effects which occurred within the first ten months of the merger. We looked first at the competition in the market before the merger. Next, we looked at Kerry's actions after it had completed the merger. Finally, we looked at possible responses to price rises, including countervailing factors. We set out our conclusions on the SLC test in paragraph 7.51.

### *Competition before the merger*

7.2 We looked at competition among FRM providers before the merger, in particular the closeness of competition between Kerry and Headland. Our analysis is set out in Appendix C. We summarize our findings here (see paragraphs 7.3 to 7.10). We also looked at the constraint provided by CRM providers (see paragraphs 7.11 to 7.15).

#### *Competition between Kerry and Headland*

7.3 Before the merger, Kerry and Headland were the largest suppliers of FRM to UK customers, accounting for [40–50] per cent of FRM by both number and value of FRM sold. The next largest supplier was Heinz, which only manufactured its own-brand FRM. Kerry and Headland together supplied a slightly higher proportion ([50–60] per cent) of own-label FRM sold in the UK. No other manufacturer accounted for more than 10 per cent of the own-label FRM supply.

7.4 Customers told us that Kerry and Headland were close competitors pre-merger for the full range of FRM and particularly so for the supply of high-volume value-range FRM because of the lack of other competitors for the supply of those FRM. The evidence submitted suggested that pre-merger Kerry and Headland were the only suppliers that fulfilled large-volume orders for customers.

7.5 Kerry told us that it did not dispute that before the merger Headland was its closest competitor in the UK market.

#### *Tenders*

7.6 FRM suppliers tend to win business through tender processes. We received evidence from customers which suggested that the degree of formality of tender processes varied considerably and that resulting agreements to supply were also of varying degrees of formality; in some cases, agreements took the form of fixed-term multi-year contracts, whilst at the other extreme the large supermarkets offered agreements for ongoing supply which could be terminated by either side on notice, typically of around 13 weeks.

7.7 We analysed the evidence from customers on the tender processes they had run to see what this showed in terms of closeness of competition between the merging parties.

7.8 This analysis showed that most tenders did not result in switching provider. Where switching had occurred, the majority of switching was to Kerry or Headland, or between them. We noted that Kerry had won significantly more contracts from

[17] Issues Statement, paragraph 6.

Headland than it had lost to it, but if we included the [✂] tender, [✂], volumes of FRM won or lost either way in the last few years were similar.

7.9 We analysed the 25 tenders for which we had information on the second-placed bidder and found that in 11 Kerry was the runner-up to Headland, and in nine Headland was the runner-up to Kerry. In the remaining five tenders, Headland was the winner and a supplier other than Kerry was runner-up.

7.10 The analysis supported evidence from customers that they preferred to maintain a relationship with a supplier rather than switch, that Kerry and Headland were close competitors, and that they were particularly important suppliers for value-range FRM.

### *The constraint from CRM*

7.11 We also looked at whether FRM prices were constrained by CRM. Our analysis is set out in Appendix D.

7.12 The differences between CRM and FRM, set out in paragraphs 2.8 to 2.11, are consistent with limited switching between CRM and FRM. Importantly, we were told that if there was a price rise in some FRM, retailers might switch within FRM but would not switch from FRM to CRM. Kerry said that it was not aware of any specific examples of retailers substituting between FRM and CRM (or any other type of ready meal) in the sense of (for instance) switching over space used for an FRM cabinet to a display of chilled meals.

7.13 Retailers' comments on the extent to which they or their customers would switch from FRM to CRM (demand-side switching) suggested that buying CRM appeared unlikely to be a viable alternative to FRM for Kerry's customers.

7.14 Moreover, suppliers of CRM we spoke to told us that they currently had no plans to supply FRM, in line with retailers' evidence that CRM suppliers would not be interested in supplying FRM (ie there is no supply-side switching).

7.15 Therefore, we concluded that the constraint from CRM on FRM was, at best, very weak and appeared not to constrain Kerry's pricing for FRM products.

### *Conclusions on competition before the merger*

7.16 We therefore concluded that before the merger, Kerry and Headland were each other's closest competitors. Customers had no significant incentive to find alternative suppliers because they were able to obtain competitive prices from Kerry and Headland. CRM did not provide a strong constraint on FRM.

## ***Kerry's actions after the merger***

7.17 We looked at Kerry's actions in respect of price and quality, range and service after the merger was completed. Our analysis is set out in Appendix E. We summarize our findings here.

7.18 Customers told us that Kerry contacted them soon after the merger and sought price rises. The details varied but several suppliers said that Kerry told them that there was no scope for negotiation on the price rises. Nonetheless, some customers did negotiate with Kerry. Table 1 sets out price rises sought both shortly before and after the merger, and the final price rises imposed.

TABLE 1 **Proposed and actual price increase by Kerry/Headland**

| *Customer* | *Pre-merger proposed price increase* | *Comment* | *Post-merger proposed price increase* | *Post-merger actual price increase* | *Date effective* |
|---|---|---|---|---|---|
| Co-op | [✂] | | [✂] | [✂] | [✂] |
| Iceland | [✂] | | [✂] | [✂] | [✂] |
| Asda | [✂] | [✂] | [✂] | [✂] | [✂] |
| Tesco | [✂] | [✂] | [✂] | [✂] | [✂] |
| Morrison | [✂] | [✂] | [✂] | [✂] | [✂] |
| Sainsbury's | [✂] | | [✂] | [✂] | [✂] |
| Marks & Spencer | [✂] | | [✂] | [✂] | [✂] |
| Birds Eye | [✂] | | [✂] | [✂] | [✂] |
| Findus | [✂] | [✂] | [✂] | [✂] | [✂] |
| Quorn | [✂] | | [✂] | [✂] | [✂] |

*Source:* Customers' submissions and hearings with CC.

*[✂]

7.19 Kerry said that the price rises it sought were to cover increases in raw materials costs and to achieve a margin of [✂] per cent.[18] Customers also told us that they understood the price rises to be aimed at recouping input price rises and raising margins.

7.20 We analysed data on the prices and volumes of FRM sold to determine the amount and extent of price changes following the merger. We used the data for FRM produced at Kerry's Carrickmacross factory as this was the most complete. We looked at the changes in production costs (taking account of increases in raw materials costs, direct labour costs and other direct production costs) and the changes in wholesale price charged to customers between July and August 2010 and July and August 2011, by which time the price rises had come into force.

7.21 We analysed the price increases overall as well as by product type, by product segment, by cuisine and by customer. As set out in Appendix E, we found that in aggregate Kerry's net prices of FRM increased significantly in July and August of 2011 (compared with July and August 2010). In total, [✂] per cent by tonnage of all products sold in July and August of both 2010 and 2011 experienced gross price increases over this period; [✂] per cent by tonnage also experienced net price increases over this period.[19] The analysis also showed that value-range FRM products were more likely to be affected by a net price increase, in terms of both the magnitude of net price increase and the share of product being affected. This finding is consistent with evidence we received from customers, who told us that the lower-cost products were more strongly affected by the merger because of the lack of alternative suppliers for high-volume low-value products.

7.22 These findings also applied to own-label FRM and own-brand FRM individually. For both segments we found large increases in net prices, which were larger for the value FRM of each segment. For contract-packed FRM (sold to only one customer), we found instead a decrease in net prices overall and only a moderate net price increase for contract-packed value FRM. We also derived net price increases for FRM based on type of cuisine. Net price increases for five of those were high, but

[18] See Kerry's initial submission, paragraphs 32 & 35.

[19] These shares are those in the FRM volumes sold to six large customers supplied from Carrickmacross; see Appendix E, paragraph 19, for details. Since a simple count of the number of products experiencing a price rise would be prone to misrepresent the impact of price rises on customers, as it would not take account of the number of units of different products sold, we indicate the share in the total tonnage above. Moreover, the value share would understate the extent of the price rises since value range FRM which account for a large share of all FRM are particularly affected.

moderate for one. Moreover, increases for value FRM were noticeably larger than those for FRM overall for only one of those six cuisines.

7.23 A breakdown by customer showed very significant net price increases for own-label and own-brand FRM sold to two large customers of Kerry, but a (smaller) decrease for those sold to two others. With one exception, net price increases were again higher for value FRM (or net price decreases lower). We discuss Kerry's response to our analysis of net price increases in Appendix E. In our view, for the reasons set out in Appendix E, paragraphs 26 to 29, its comments do not undermine our analysis or conclusions.

7.24 We used this analysis to determine whether price rises in excess of increases in production costs had been achieved after the merger. However, as the price rises had only just come into effect we had little data for the period after the price rises were implemented. Although the evidence is useful in giving us an indication of the short-term effects of the merger, it does not allow us to determine the extent to which such effects could be sustained by the parties in the longer term.

7.25 Suppliers' 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, in full or in part, 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.

7.26 We conclude that the merger had reduced the level of competition in the market. After the merger was completed, Kerry sought and, at least initially, achieved significant price increases from many of its customers. We next assessed customer responses to the price rises and possible countervailing factors.

### *Responses to price rises and possible countervailing factors*

7.27 We looked at the options customers had in response to the post-merger price increases. We looked first at the possibilities of finding alternative suppliers in the UK and Republic of Ireland, and the scope for those suppliers to expand production capacity (see paragraphs 7.28 to 7.32). Next, we looked at the possibility of finding alternative suppliers in the rest of the EU through imports (see paragraphs 7.33 to 7.41). Finally, we looked at what customers actually did in response to price rises from Kerry (see paragraphs 7.42 to 7.48). We set out our conclusions in paragraphs 7.49 and 7.50.

#### *Alternative supply in the UK and Republic of Ireland*

7.28 We looked at the spare capacity available in the UK and Republic of Ireland among existing suppliers of FRM. Our analysis is set out in Appendix F, and we summarize our findings here.

7.29 Kerry estimated that there was spare capacity among its largest UK competitors to produce over 200 million FRM per year, though we noted that one of those competitors has ceased production and shut down. We obtained evidence from the largest FRM suppliers in the UK and Republic of Ireland (excluding Kerry), and found that overall there appeared to be spare capacity to produce around 90–100 million units per year. We noted that this might overestimate the spare capacity available for customers to switch from Kerry as those potential suppliers with spare capacity did not all express an interest in using that capacity to make up for the loss of Headland's

production. Some of these suppliers told us that their capacity was likely to be used to produce FRM for customers requiring large volumes and some expressed caveats on its use more generally. Although the evidence was not clear cut, it suggested that there was spare capacity available for use by Kerry's customers among these suppliers.

### *Expanding production capacity*

7.30 Kerry said 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.

7.31 We spoke to other FRM suppliers who told us about the costs of installing lines (see Appendix F). These lines were of varying sophistication, size and capacity. Their costs varied from £100,000 to over £2 million. Time frames for installation were around three to four months.

7.32 This suggests that adding new capacity through new lines need not be prohibitively expensive, as long as there is existing space to house extra lines. The relatively low-margin nature of FRM production suggested, however, that there is limited appetite for expansion without guaranteed business on the part of suppliers. 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. Having noted these limitations on spare capacity and expansion, we also noted that some customers have switched, or are switching, to UK suppliers (see paragraph 7.44).

### *Imports*

7.33 Kerry's views on imports are set out in Appendix F. In summary, Kerry said that ready meals manufacturers in the rest of the EU and even further afield can and do compete effectively to supply FRM into the UK and it was immaterial whether the FRMs were own label, contract packed or own brand. Kerry said that the costs of manufacturing FRM in the EU were comparable to those in the UK and the Republic of Ireland. It noted that several importers were already active in the UK, and it collated a list of 38 actual or potential FRM suppliers on mainland Europe.

7.34 We spoke to five current importers, customers and UK suppliers about imports as a constraint on UK supply of FRM. Their views are set out in Appendix F, paragraphs 24 to 27. As at October 2011, there were seven importers supplying major customers in the UK. However, most of these are supplying only a few lines and in more than one case only one product is supplied. We identified more than one importer that intended to supply into the UK in the coming months as a direct consequence of the post-merger price increases causing customers to look for alternative suppliers. We also received evidence that other customers were at an early stage of looking for new overseas suppliers (see Appendix F, paragraph 27). The evidence we obtained from these alternative suppliers suggested to us that there is no shortage of spare capacity in Western Europe (see Appendix F, paragraph 24), though some of the importers appeared to be unable or were not interested in supplying FRM to the UK at pre-merger prices, and at least one had not yet determined at what prices it would be able to supply into the UK.

7.35 Before the merger, Kerry and Heinz successfully imported FRM from within the euro zone (both from the Republic of Ireland) but no other importers had achieved significant sales to UK customers. We looked at whether there were any reasons why

importers from the Continent should not be able to import successfully to UK customers.

7.36 The most significant issues raised regarding imports related to the cost of supplying from overseas, exchange rate issues, and matching UK taste.

7.37 We found that transport costs from the Continent were greater than costs for supplying within the UK or for Kerry supplying from the Republic of Ireland (see Appendix F, paragraphs 30 to 33). However, we found that transport costs from closer parts of Europe such as Belgium, north-west France, north-west Germany and the Netherlands do not appear to be much higher than transporting from within the UK or from the Republic of Ireland. Transport from further afield appeared less attractive unless there were significant cost savings in production—though we noted that one more distant supplier had won some business since the merger, suggesting that imports from across Western Europe are feasible.

7.38 We were told that the exchange rate with the euro had been unfavourable for importers for several years. However, a significant proportion of costs are raw materials costs which are commodity price related and could therefore be hedged against exchange rate movements. We also noted that Kerry has continued successfully to import FRM at all price points over the period (see Appendix F, paragraph 36).

7.39 We were also told that different countries have different taste profiles and some customers had experienced difficulties in finding suppliers able consistently to produce products which met UK tastes. We did not think that this was a significant barrier to supplying UK customers; several importers we spoke to used chefs who were either British or had significant experience of working in the UK, and we saw no reason why a supplier wanting to win UK business could not make similar provision if necessary. We also noted that recipes were tightly defined by customers, limiting the scope for problems in matching UK taste profiles (see Appendix F, paragraphs 37 to 40).

7.40 Overall, we found that importing FRM presents challenges, but we saw no substantive reasons why suppliers based on the Continent could not supply UK customers. We also noted that customers' comments generally suggested that they had considered imports as a consequence of the price increases that followed the merger, that, as at October 2011, there were already seven importers supplying major UK customers, and that more than one new importer would start supplying into the UK as a consequence of actions taken since the merger.

7.41 We therefore conclude that imports should be able to offer a constraint on Kerry's ability to impose price rises in the future. Imports also offered some level of constraint to render the price rises Kerry has already imposed unprofitable through loss of business. Whilst before the merger levels of imports from the Continent were small and customers were not sufficiently familiar with the possible overseas suppliers to know to whom they could turn (we noted that while Kerry provided us with a list of 38 actual or potential importers, customers were able to name very few of these), in our view the merger has created the incentive for customers actively to research their import options, and for potential importers actively to make themselves known to UK customers; in this respect we are aware of some customers who have not switched who are currently looking at overseas alternatives.

### *Customers' responses when faced with price rises*

7.42 Several customers of Kerry told us that the merger had reduced their negotiating power with Kerry.

7.43 We set out in Table 1 the price rises sought by Kerry and the price rises eventually imposed. Kerry told us that since the merger it had lost nearly £[40–45] million of business across [✂] customers, either through products being switched to alternative suppliers or being delisted.

7.44 We looked at what customers did, or were actively planning to do in response. We set out our evidence in Appendix G. The evidence showed clearly that many customers were able to find alternative FRM suppliers for ranges of products within the UK and overseas, albeit at significant cost in one case, and that these suppliers were nearly all able to supply at prices cheaper than Kerry's post-merger prices. In most cases, the prices customers are paying after switching are at or around the prices in the market pre-merger, or if they are higher, are generally higher to an extent that could be explained by increases in raw materials costs.

7.45 This evidence suggested to us that reasonable switching options were not restricted to certain customers or types of customer post-merger:

- We have examples of different types and sizes of customers who have already managed to switch successfully.
- There is no reason to believe that those who have not yet switched display characteristics which substantially differentiate them from at least one of those who have already done so.
- Furthermore, we know that many of those who have not yet switched are exploring options to do so.

7.46 Nor did we see any reason to believe that actual or planned switching would be unsuccessful such that customers would have to return to Kerry.

7.47 Finally, as set out in paragraphs 7.29 and 7.34, there is plenty of spare capacity currently available, to some extent in the UK and to a much larger extent through imports from Western Europe. Whilst some customers may have concerns over some importers' ability to meet their needs, the evidence suggested to us that switching opportunities have not been exhausted by the early movers.

7.48 Given this situation, we find that customers have sufficient alternative providers to be able to switch away from Kerry, or threaten to do so, such that Kerry will be constrained from imposing prices which exceed pre-merger levels by substantially more than the increases in cost. Therefore, Kerry's ability to charge higher prices as a result of the merger is unlikely to persist beyond the short term.

### *Conclusions on responses to price rises and possible countervailing factors*

7.49 We found that there are suppliers both in the UK and overseas who have spare capacity for the production of FRM, who should be able to provide a constraint on Kerry's ability to raise prices. The evidence on what some customers—who represent a significant proportion of Kerry's business—have done since the merger indicated to us that customers are able to find alternative suppliers for FRM products or groups of products both in the UK and overseas. Moreover, the prices customers are paying after switching are at or around the prices in the market pre-merger, or if they are higher, are generally higher to an extent that could be explained by increases in raw materials costs.

7.50 We therefore conclude that, before the merger, customers had no significant incentive or need to find alternative suppliers to the merging parties. The merger provided

customers with an incentive to seek alternative suppliers, as there has been a reduction in the number of significant competitors supplying FRM in the UK. With time and effort, and in at least one case some cost, customers have been able to find alternative competitive suppliers for products covering the whole range of FRM. We therefore conclude that the merger only allowed Kerry to impose price increases on a large share of the FRM volume in the short term. In our view, customers have sufficient alternative providers, in the UK and overseas, to be able to switch away from Kerry, or threaten to do so, such that Kerry will be constrained from imposing prices which exceed pre-merger levels by substantially more than the increases in cost. Therefore, Kerry's ability to charge higher prices as a result of the merger is unlikely to persist beyond the short term. The merger has not, therefore, resulted in an SLC.[20]

### *Conclusions on the SLC test*

7.51 We conclude that the merger did not and was not expected to result in an SLC in any market or markets in the UK for goods or services.

[20] In its response to our provisional findings, Authentic raised the concern that in the long term Kerry's lower cost base and purchasing power would enable it to eliminate competitors through aggressive competition on price. We satisfied ourselves that in the foreseeable future a sufficient number of manufacturers will be able to compete effectively with Kerry in the supply of FRM. We considered that it is hard to predict with any degree of certainty how competition will evolve in the longer run, and that we could not predict how events will unfold in the more distant future. Therefore, we did not consider this concern further.