

PORK FARMS CASPIAN / KERRY FOODS MERGER INQUIRY

Summary of hearing with Kerry Foods Limited on 4 March 2015

Background

1. Kerry Foods Limited (**Kerry**) was part of the Kerry Group, a multinational food ingredients and local consumer foods business. Kerry exited the CSP manufacturing market with the sale of its CSP production facilities to Pork Farms, though it sold CSP products now manufactured by Pork Farms.
2. Kerry viewed the CSP market as a very traditional market that was difficult to innovate in. Kerry saw little growth in the CSP market and flat performance by Kerry within the CSP market. Kerry said that it struggled to see what it could do to foster growth within the CSP market.
3. Kerry explained that cold pies had a summer bias, with a spike at Christmas, whilst hot pies had a winter bias. For sausage rolls, peaks in demand would be driven by promotional events. Kerry would, to some extent and with customer agreement, manage the key peaks by freezing products in advance.

Kerry's CSP business and decisions to exit

4. Kerry believed that its CSP business was proving difficult to meet Kerry Group's stated ambition to grow the business and expand margins. After reviewing the business, Kerry decided in summer 2013 to exit the CSP market.

The sale

5. Kerry said that it was aware that Pork Farms had been trying to sell its business in 2013. After this had apparently fallen through, Pork Farms approached Kerry enquiring whether it was prepared to sell its CSP business. This approach ultimately resulted in Kerry selling the CSP business to Pork Farms in August 2014. This resulted in Kerry taking up a minority interest in the Pork Farms Group.

6. Kerry explained that the timing of the attempted sale of Pork Farms had been instructive to Kerry. Kerry took the view that the apparent failure of Pork Farms to secure a sale of its business would indicate that a sale of Kerry's CSP business would be very difficult. However, when approached by Pork Farms with the proposal that Pork Farms might acquire the Kerry CSP business, Kerry felt that the overall solution, including Kerry taking up shares in Pork Farms Group, was an acceptable solution. Kerry anticipated that it would potentially result in Kerry realising its assets in the business in the medium to long term.

Counterfactual

7. Kerry explained that while it had made a decision in 2013 to exit the CSP market, this did not imply that it had plans to close its CSP operations. A closure of the operation would be too expensive, both in terms of redundancies and in terms of the damage such a closure would do to Kerry's relationship with its customers. Kerry said that its approach to operating the business in the future would have been to maintain the business in its current state pending a future sale.
8. Kerry said that, in the interim, before sale, Kerry would have maintained the business in its current position. However, Kerry would not have pursued new business. Kerry explained that it would have committed to capital investment in the site as necessary in order for the business to retain its retailer approval status. However, Kerry would not have envisaged capital investment for other purposes where the payback was longer or less certain.

Customer behaviour

9. Kerry said that about [70–80]% of the CSP businesses' revenue was through two of the largest grocery multiples, although the CSP business also had significant contracts with other grocery multiples. Although the CSP business provided a wide range of CSP products, the CSP business did not supply the full range of any one retailer.
10. Kerry said that it worked hard across its full range to develop a collaborative relationship with retailers, and Kerry carried this philosophy into its customer relationship in the CSP area. Kerry said that it understood that the environment for all retailers was very challenging at the moment, particularly for the 'Big 4' retailers. Although the 'Big 4' still retained a large (greater than 70%) market share, they were under pressure from growth in both the lower and the top end of the retail grocery markets.

Market definition

11. Kerry said that it did not hold evidence on consumer switching in CSP products. Kerry had observed a fall-off in consumers as a result of a small price rise, for example a 5-10% rise in the price of sausage rolls. However, Kerry explained that it had not seen any analysis of whether these consumers were exiting the CSP market or switching to other CSP products. Kerry observed that a major driver in the CSP market was promotions, with a significant proportion of consumers seeking out the products on the best promotion.

Existing competition in the supply of CSP products

12. Kerry said that prior to the Transaction, Kerry competed most closely with both Pork Farms and Samworth and considered Peter's and Welsh Pantry as credible competitors. For the main contracts with the major retailers, although price was clearly important, Kerry also believed that the quality of the product and the suppliers' service levels were equally important. These factors were critical to gaining and maintaining the retailers business.
13. Kerry explained that contracts with retailers tended to be long-term (for example business with one large grocery multiple had been with the Poole site for many years), however, contracts could in general be terminated on 12 weeks' notice. Kerry explained that, in general, as long as the suppliers retained the service and quality levels then customers generally supported the supplier and maintained their business with them. When trying to negotiate price increases with retailers, on the back of raw material increases, Kerry said that it would feel in a stronger position in those negotiations if it was confident that the retailer was happy with Kerry's recent quality and service standards.
14. Kerry provided a few examples of where it had lost CSP business in the recent past. In particular, Kerry highlighted a contract for a grocery multiple that was lost to Welsh Pantry.

Capacity

15. Kerry confirmed that the business had capacity on all lines on a week-to-week basis, but that the business had to maintain some of this capacity to meet peaks in demand. Kerry emphasised that there were some weeks where the demand from retailers outstripped the business' capacity to produce. In these circumstances, and with customer agreement, Kerry would freeze products in advance in order to meet these peaks in demand. Kerry did have other

options over the medium to long term to increase, such as increasing shift patterns. However, these would be difficult to implement in the short term to meet an uplift in demand. This meant that Kerry could have taken on significant additional business without the need for major capital investment.

Expansion

16. Kerry said that it, and other CSP businesses, had the ability to expand their operations, given the right incentives on offer to mean the investment needed would make business sense. Kerry said that it was aware of a second-hand equipment market that would allow CSP businesses ready access to reasonably priced and well-maintained equipment.

Entry

17. Kerry explained that there were a number of avenues for businesses to enter the CSP market. Cranswick were primary processors who were looking to come up the value chain, while Welsh Pantry had been around for a while, but had expanded much more rapidly than Kerry anticipated. Kerry further explained that Peter's had recently entered the market for supplying multiples – an area it had not appeared to be interested in until recently.

Exit

18. Kerry said that it was aware of recent exits from the CSP market from the likes of Northern Foods and RF Brookes, but had no real insight into the reasons for the companies' exit from the market, other than their loss of significant levels of business.