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## Completed acquisition by Premier Foods Plc of the UK desserts business of Kraft Foods Inc

The OFT's decision on reference under section 22 given on 24 May 2005. Full text of decision published 3 June 2005.

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Please note square brackets indicate information replaced by a range or excised at the request of the parties for reasons of commercial confidentiality.

### PARTIES

1. **Premier Foods Plc (Premier)** is a UK company whose shares are listed on the London Stock Exchange. It is active in the UK and the rest of Europe in the production and sale of grocery products, including convenience foods, pickles, sauces, beverages, spreads and ambient desserts.
2. **Kraft Foods Inc. (Kraft)** is a US company whose shares are listed on the New York Stock Exchange. It is active worldwide in the production and sale of branded food and beverage products. Kraft's UK desserts business is carried on under the Bird's brand. The turnover associated with this business in the last financial year was approximately £36.8 million.

### TRANSACTION

3. On 13 February 2005 Premier acquired the assets comprising the UK desserts business of Kraft carried on under the Bird's brand (**Bird's**). The administrative deadline for consideration of the transaction expires on 6 June 2005.

### JURISDICTION

4. As a result of this transaction Premier and Bird's have ceased to be distinct. The parties combined share of supply of custard exceeds 25 per cent. Therefore the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

### RELEVANT MARKET

5. In the UK Premier manufactures and sells the following ambient desserts:
  - ready-to-eat (RTE) milk puddings and custards under the Ambrosia brand
  - RTE jellies under the Rowntree's brand, and
  - desserts sold under retailers' own brands.

6. Bird's manufactures and/or sells the following products in the UK:
  - custard (instant, powdered, ambient RTE and chilled RTE)
  - instant cold desserts (Angel Delight)
  - branded desserts such as trifle (Dream Topping), semolina and jelly
  - Christmas sauces (RTE and instant brandy flavoured custards), and
  - desserts sold under retailers' own brands.
7. The parties overlap in the manufacture and supply of desserts, in particular the manufacture and supply of RTE custard and jelly.

### **Product market**

8. Custard can be segmented into four main types:
  - powdered custard: this needs to be heated with milk and sugar to make custard
  - instant custard: this is mixed with hot water to make custard
  - ambient RTE custard: this comes in tetra packs and can be stored at room temperature and either eaten cold or warm, and
  - chilled (or fresh) RTE custard: this custard must be kept in the fridge and can either be eaten cold or warm.<sup>1</sup>
9. Custard is sold in different sizes of packaging. Ambient and chilled custard in particular can either be bought in small individual sized pots (125g) or in larger packs (425g/500g sizes tend to be the most popular).
10. The extent to which different types of custard pose a constraint on each other, and the extent to which they in turn are constrained by other desserts or dessert accompaniments, is discussed below. The extent to which jelly is constrained by other desserts is also considered below.

### **Geographic market**

11. Both of the parties supply their products nationally and many of their customers purchase on a national basis. The geographic scope for the supply of the products in question is therefore at least UK-wide. While a number of custard suppliers are not based in the UK, the fact that custard is used more widely as a dessert accompaniment in the UK than elsewhere in Europe, and the strong national branding of Ambrosia and Bird's, suggest that it is appropriate to limit the competition analysis to the UK.
12. However, in contract manufacture of custard, a number of companies (including Bird's) source products from Continental Europe, suggesting that for manufacture of custard products the relevant geographic scope may be wider than the UK. As no concerns arise in this segment, it is not necessary to conclude on this point.

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<sup>1</sup> In addition, custard can also be made using milk/cream, sugar and eggs.

## HORIZONTAL ISSUES

### Market shares

#### Custard

13. Both of the parties supply ambient RTE custards; in addition, Bird's sells chilled, powdered and instant custards. Table 1 shows the parties' shares of supply, in:
- ambient RTE custard
  - all custards (powdered, instant, ambient RTE, chilled RTE)
  - ambient desserts, and
  - all desserts.

**Table 1: Parties' shares of supply by value (2004)**

Supplier	Share of supply by value (%)			
	Ambient RTE custard	All custard	Ambient desserts	All desserts
Premier	70-80%	50-60%	20-30%	0-10%
Bird's	0-10%	20-30%	0-10%	0-10%
<b>Premier post-merger</b>	<b>80-90%</b>	<b>70-80%</b>	<b>20-30%</b>	<b>0-10%</b>

14. The merger results in an increment in share of supply in respect of both ambient RTE custard and all types of custard, although the increment is much lower in respect of the former.
15. Ambrosia (Premier) and Bird's are the two main custard brands in the UK, with the remaining shares of supply predominantly accounted for by own label custard products manufactured by dairy processors such as Arla and by other European manufacturers. The parties argue that own label products are a competitive constraint and that in particular the higher quality own label ranges, such as Tesco's 'Finest' and Sainsbury's 'Taste the Difference', are brands in their own right. In general market intelligence and responses from third parties support the assertion that own label products could pose a constraint. While not all grocery stores have own label custard products, the ease of entry into own label custard (see below) suggests that the threat of increased own label production is credible.
16. The crucial question with regard to unilateral effects is whether ambient RTE custard competes with chilled RTE custard and with powdered and instant custard, and whether all of these (or particular subsets of these) compete with other desserts and/or dessert accompaniments.
17. The evidence available to us regarding the degree of substitutability between the different types of custard is mixed. Third party responses received by us and market intelligence suggest that many consumers will buy one type of custard and not necessarily consider others as substitutes. In particular it has been suggested that the demographic for powdered and instant custard is older than for RTE custards; younger customers chose ready-made alternatives. In terms of price, powdered custard is significantly cheaper than RTE custard (around eight

times cheaper than own label ambient RTE custard and about 12 times cheaper than branded (Ambrosia) RTE custard).

18. Third parties in general considered that chilled and ambient RTE custards were closer substitutes. Their prices are generally more comparable, with chilled custard being slightly more expensive, and movements in prices of (Bird's) chilled and (Ambrosia's) ambient custard are more (positively) correlated with each other than either are with the other custard types (powdered and instant). However, when considering the volumes of different products sold, on the whole there is very limited evidence of demand substitution between product types. The constraint from the supply side is limited as the production processes are particular to the different custard types.
19. The parties are of the view that custard sales are constrained by other desserts and dessert accompaniments, and that, while small 125g pots of RTE custard would compete with other 'snack' foods such as yoghurts and mousses, larger packages of custard tend mostly to be used as an accompaniment to desserts, therefore competing with products such as cream and ice cream. Internal market research conducted for Premier by Added Value (AV) in spring 2004 shows that, for both routine meals and for social occasions, survey participants considered ice cream, cream and fresh cream, as well as custard, to be suitable normative choices for a dessert accompaniment. In terms of consumption 'on its own', a number of foods were identified as alternatives to custard as a 'snack' or a 'healthy dessert', including canned fruit, rice pudding, yoghurt and cheesecake.
20. The parties also point out that, in so far as a producer is unable to differentiate between the different ways in which custard is consumed, in setting a price it has to take account of prices of all the different groups of possible substitutes. These products in turn compete with other dessert products, thereby establishing a chain of substitution. Although not all third parties that we contacted were convinced that custard is a dessert in its own right and that it therefore competes with other desserts, all third parties considered that custard does compete with other dessert accompaniments, such as cream and ice cream. These products – and possibly other dessert products by way of a chain of substitution – therefore provide a constraint on Premier's custard business after the merger. The merged entity's share of supply, if cream and ice cream are included, is below 10 per cent.<sup>2</sup>

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<sup>2</sup> The Keynote Report on Ice Creams and Frozen Desserts (2005) valued the market for take-home ice cream and scoop or soft-mix ice cream (i.e. excluding impulse ice cream) at £848 million in 2004. The total market for custard in 2004 was £80.7 million; Premier and Bird's total custard revenues were [...]. On the basis of sales of ice cream and custard, Premier's post-merger share is [0-10] per cent. It would be even lower if cream was included. Neither Bird's nor Premier produces cream or ice cream.

## Jelly

21. Table 2 shows the parties' UK shares of supply for jelly.

**Table 2: Shares of supply by value – jelly (2004)**

<b>Supplier</b>	<b>Share of supply (%)</b>
Premier	80-90
Bird's	0-10
Kerry Group (Green's)	0-10
Retailer brands	10-20
<b><i>Premier post-merger</i></b>	<b><i>80-90%</i></b>

22. The increment in share of supply is very low but the level of market concentration is high. However, the parties and all third parties who responded to our inquiries are of the view that jelly competes with other desserts. The survey conducted by AV's for Premier suggests that canned fruit, fromage frais, hot puddings and rice pudding are all close substitutes for jelly. As noted in table 1, Premier and Bird's combined share of supply of all desserts is less than [10] per cent, so competition concerns do not arise in relation to this product overlap.

### **Barriers to entry and expansion**

23. The parties state that entry into any custard or jelly segment could be accomplished most readily through brand extension by existing dessert manufacturers for whom the costs of brand development would be much lower. For new entrants into the desserts sector, the cost of developing a brand is estimated by one third party at around £20 million. The parties believe that for existing branded dessert manufacturers, advertising and marketing costs would be minimal, and they have cited numerous examples of such entry, for instance the introduction by Müller Dairy of 'Custard and sponge' in 2001 and 'Crumble and custard' in 2003.
24. In addition, virtually all of the major UK retailers have launched own label custard products, in both standard and premium variants. Our enquiries also showed that some dessert manufacturers already produce custard or jelly for use in other desserts, such as trifle. The costs for retailers to develop own label custard products are relatively modest. One third party suggested that an investment of around £50,000, with an estimated development time of 6 months would be sufficient; costs for catering-size production are lower. On the assumption that own label accounts for 1 per cent of the total supply of custard in the UK and margins of around 30 per cent, these costs could be recouped in just over two years.
25. Responses from third parties have confirmed that there are a number of contract manufacturers who produce custard. While one third party expressed concerns about the availability of contract manufacturers for own label supply given the closure of Dairy Farmers of Britain's custard producing plant earlier in the year, a number of other producers of own label custards remain, including Arla, Campina, Kerry Foods and Milk Link for ambient RTE custard.

26. In view of the above, it is concluded that barriers to entry are low in respect of entry by retailers into the own label segment and by existing food/dessert manufacturers into the branded segment.

### **Buyer power**

27. According to Mintel, approximately 87 per cent of chilled desserts and 79 per cent of ambient desserts are sold by grocery multiples in the UK.<sup>3</sup> Premier also notes that approximately half of its sales are to three customers, namely [names of three national multiples]. By virtue of their size, grocery multiples have a high degree of buyer power. Even if Bird's or Ambrosia custard were regarded as a must-carry products, the large multiples are likely to be able to exercise portfolio buyer power by virtue of being able to retaliate in other product markets where the strength of Premier's brand is weaker.
28. We considered whether smaller customers that do not necessarily possess such buyer power currently use the fact that there are two well known brands of custard to secure a better deal from one of them. However, all the customers that we spoke to stock a number of types of custard, supplied by both Premier and Bird's (according to data submitted by Premier, virtually all of the customers that stock Ambrosia custard products also stock Bird's products). Therefore such a strategy could only realistically emerge in relation to ambient RTE custard, where the activities of the parties overlap. Evidence suggests that ambient RTE custard (in particular branded ambient RTE custard) is unlikely to be a must-carry item for smaller groceries. Therefore the merger will not have any significant impact on the level of buyer power possessed by these customers. In addition, the fact that own label supply seems viable for many retailers and wholesalers in this sector, and the possibility of introducing brands from Continental Europe which was highlighted by some retailers, may result in even smaller grocers being able to exercise some buyer power.

### **VERTICAL ISSUES**

29. This merger does not raise vertical competition issues. Both parties are to some extent active in contract manufacture of custard, however, their joint shares of supply in this segment in the UK (for ambient and chilled RTE custards, and for all custard) are below 10 per cent.

### **THIRD PARTY VIEWS**

30. There was a limited response to our inquiries. Most respondents were unconcerned but some customers did express some concern about the reduction in the number of branded custard products, however these concerns were not substantiated by our analysis; in particular there was no evidence that customers play off the two brands against each other in order to negotiate better prices. DEFRA was not concerned about the merger.

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<sup>3</sup> Mintel, Chilled Pot Desserts, Market Intelligence July 2004.

## **ASSESSMENT**

31. The parties' combined share of supply of all custard, ambient RTE custard and jelly is high, although the increment in respect of the latter two segments is very small. Moreover, the merger brings together the two main custard brands in the UK.
32. Our analysis indicates that from a demand perspective custard is constrained by other dessert accompaniments such as cream and ice cream and that other desserts are likely to pose a constraint on the supply of custard due to the operation of a chain of substitution. Evidence also indicates that jelly competes with other desserts; the parties' share of supply in the desserts sector as a whole does not give rise to concerns.
33. Moreover, barriers to own label product development are low and the costs for an existing dessert manufacturer to expand into the supply of branded custard or jelly are modest. Finally, most customers possess portfolio buyer power. There is no evidence that customers who do not possess portfolio buyer power have in the past been able to negotiate better prices by playing off the two custard brands against each other; in this respect they are unaffected by the merger.
34. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

35. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.