ACE conference

Merger between Cofigeo and Agripole

A merger in the prepared food market in France

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THE TRANSACTION

- On 12 June 2017 Cofigeo notified the French Competition Authority of its intent to acquire exclusive control of some of the assets used to produce prepared sterilised meals from Agripole.
- This Transaction follows the dismantling of the Financière Turenne Lafayette ("FTL") group, which headed the Agripole group, leading to other divestments.
- The Parties are both present in the market for sterilised prepared meals (prepared meals) in France for the following segments:
  - French prepared meals ('PCF') ;
  - Italian prepared meals ('PCI') ;
  - Exotic prepared meals ('PCE') ;
  - Microwavable prepared meals ('MO').

List of brands of prepared meals of the Parties

Prepared meals segment	Cofigeo	Agripole
PCF	Raynal et Roquelaure (RR)	William Saurin (WS) Julien Mack Petit Jean La Belle Chaurienne Les Bories du Perigord
PCI	Zapetti	Panzani
PCE	Zapetti	Garbit

Note: In blue, brands part of the Transaction.
Source: Decision 18-DCC-95.

MARKET SHARES OF THE PARTIES

- Post-merger, the Parties would have high market shares in several segments of the market – which may *prime facie* raise competitive concerns.

Branded products (MDF) / Private labels (MDD)	Parties	PCF		PCI		PCE	
		Shares (%)	Market sizes (M€)	Shares (%)	Market sizes (M€)	Shares (%)	Market sizes (M€)
MDD+MDF	**Combined**	**[40-50]%**	335.6	**[80-90]%**	133.9	**[70-80]%**	61.4
	Cofigeo	[10-20]%		[30-40]%		[20-30]%	
	Agripole	[30-40]%		[40-50]%		[40-50]%	
MDF	**Combined**	**[40-50]%**	224.2	**[80-90]%**	84.7	**[80-90]%**	38.0
	Cofigeo	[10-20]%		[30-40]%		[20-30]%	
	Agripole	[30-40]%		[40-50]%		[50-60]%	
MDD	**Combined**	**[30-40]%**	111.4	**[80-90]%**	49.2	**[50-60]%**	23.4
	Cofigeo	[5-10]%		[40-50]%		[20-30]%	
	Agripole	[20-30]%		[40-50]%		[20-30]%	

Source: Decision 18-DCC-95.

ECONOMIC CONTRIBUTION

- We developed a merger simulation model to estimate the possible unilateral effects of the Transaction taking the pre-Transaction situation as a reference (a reasonable benchmark according to FCA).
  - Brands of the merging Parties are not each other's closest competitors;
  - Private labels impose a strong competitive constraint on branded products, in particular on the Parties' brands;
  - Unilateral effects arising from the merger are likely to be moderate.

- We considered that the simulated price effects likely overestimated the price effects resulting from the Transaction.
  - The pre-Transaction situation is not a reasonable benchmark for assessing the effects of the Transaction.
    - Agripole was in a state of bankruptcy.
    - Part of Agripole's production capacity would have been shut down absent the Transaction.
    - Less production capacity would have been available for private labels.
    - Private labels would have exerted lower competitive pressure on the Parties' brands.
    - Absent the Transaction, prices would have been higher than observed in the pre-Transaction situation.
  - The combined entity may have had little incentives to increase prices as it could have jeopardize profitability of certain production assets.
  - Distributors such as Carrefour, Leclerc, etc. would have been able to discipline the combined entity by (e.g.) threatening to discontinue some of its products.

- We discuss those various items in the remainder of the presentation.

MEASURING UNILATERAL EFFECTS

- To quantify the unilateral effects arising from the Transaction, we assess:
  - To what extent the brands of the Parties are close competitors; and
  - To what extent private labels impose a competitive constraint on branded products.
- Ideally, one would econometrically estimate consumer demand in order to obtain point estimates for demand elasticities.
  - However, a comprehensive study would not have been feasible in the time available.
- As an alternative, we conduct a series of calibrated merger simulations.
  - These were designed to allow for a broad range of plausible demand elasticities, which would result in econometrically-estimated elasticities falling within the ranges of the calibrated elasticities.
- The logit structure of demand was selected due to minimal data requirements.
  - Nesting was used to allow for more differentiation between segments and to reduce the drawbacks of IIA.

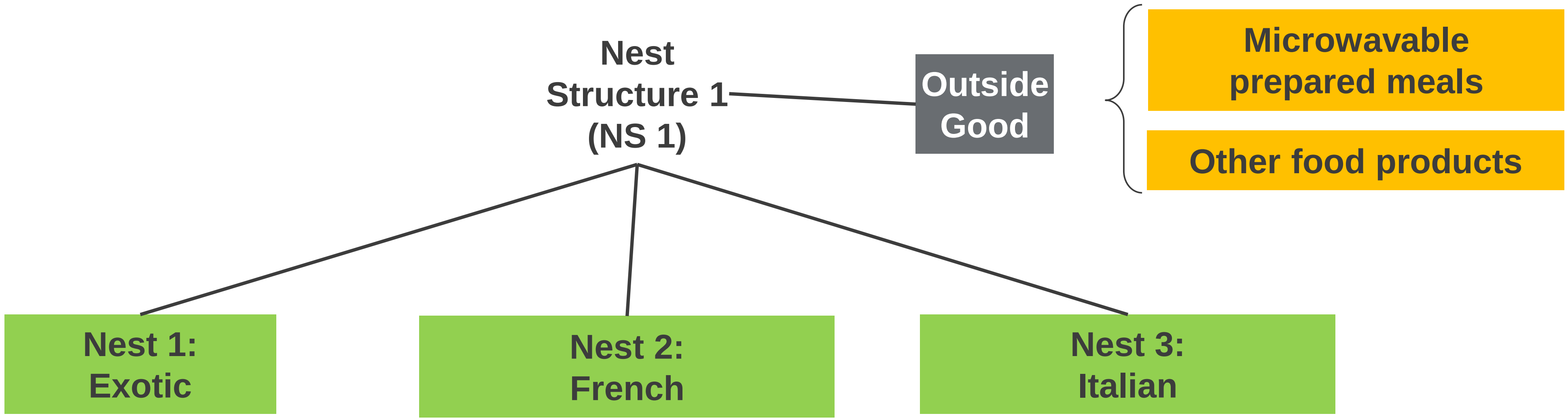
NESTED LOGIT - ADVANTAGES AND LIMITATIONS

- The logit structure of demand has several advantages:
  - Computationally attractive;
  - Data needs are relatively minimal, requiring SKU level data (typically, cross section variability suffices);
  - Relatively easy way of modelling substitution patterns between different segments.

- The logit structure of demand has several limitations :
  - The structure is somewhat rigid, as the assumed nest structure imposes restrictions on patterns of substitution among the differentiated products;
  - Independence of Irrelevant Alternatives (‘IIA’);
    - IIA property implies that if the price of one good increases, consumers switch to other goods in proportion to the latter's market shares.
  - Cross-price elasticities are proportional to shares;
    - Closeness of substitution within a nest depends on the relative size of the shares of the brands.
  - Elasticities proportional to prices;
    - All else equal, more expensive products tend to be less elastic.
  - Requires an assumption on the aggregate demand elasticity.

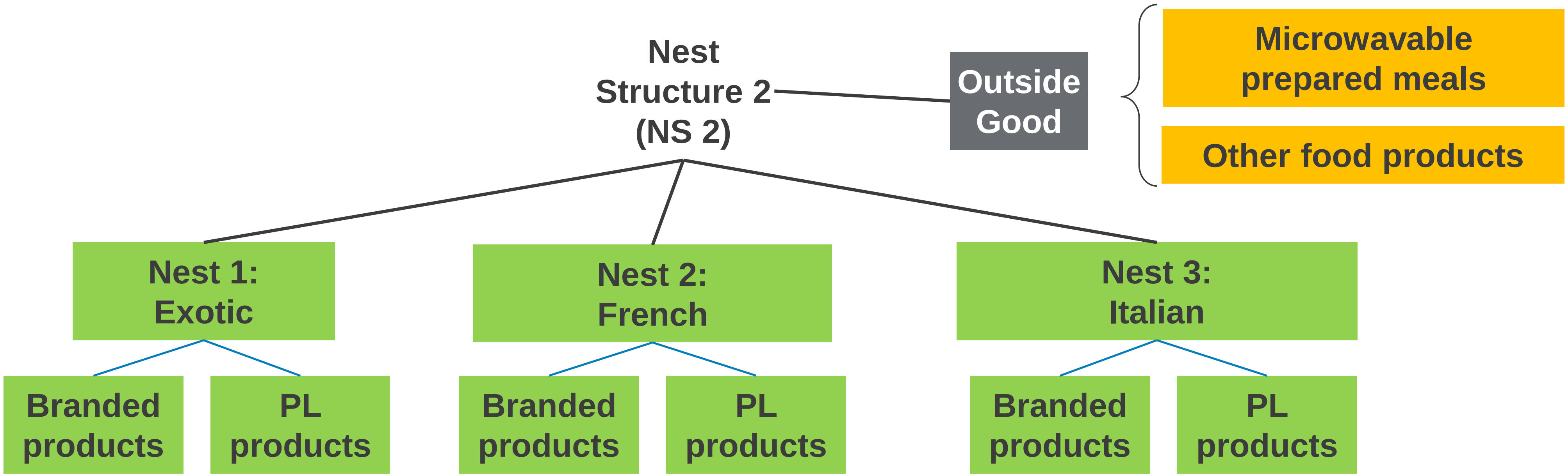
NEST STRUCTURE 1

- Nest structure 1 ("NS 1") consists of three nests as set out in the diagram below:
  - Exotic prepared meals ;
  - French prepared meals ; and
  - Italian prepared meals.
- Branded products and private label products compete directly within each nest.
- The outside good contains microwavable prepared meals and other food products.
- Substitution between products within the same nest is stronger than substitution across nests.
- Substitution within each nest is proportional to shares in the nest.



NEST STRUCTURE 2

- Nest structure 2 (“NS 2”) consists of three primary nests as set out in the diagram below:
  - Exotic prepared meals ;
  - French prepared meals ; and
  - Italian prepared meals.
- The nest structure also contains two sub-nests within each primary nest:
  - Branded products ; and
  - Private label (‘PL’) products.
- Sub-nests reduce direct competition between branded and private label products within each primary nest.
- The outside good contains microwavable prepared meals and other food products.



FCA RESERVATIONS ON THE MODEL

- The Model does not take into account that the Parties also manufacture private labels.
  - The manufacturing of private label products by Cofigeo and Agripole has not been directly factored in the nested logit model, because it would require assumptions on (notably):
    - production capacity; and
    - the decision-making process of both Parties as to how they would allocate production capacity between private label products and their own branded products.
  - In practice, this simplification has limited impact on simulated price effects.

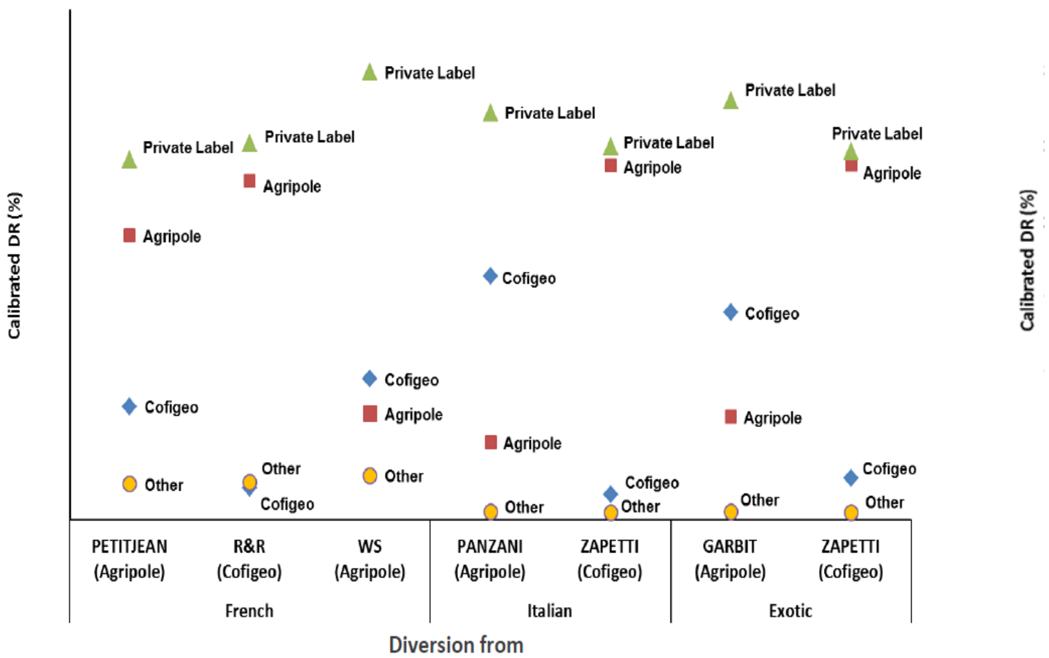
- The Model does not take into account the capacity constraint faced by competitors.
  - This is not fully accurate to the extent capacity constraints exist pre-Transaction and are not affected by the Transaction (according to FCA).
  - The calibration of the model, based on market data and therefore reflecting competitive constraints exerted by competitors pre-Transaction, indirectly accounts for capacity constraints in the pre-Transaction situation.

- The Model with a two-level structure is more suitable.
  - NS1 allows for direct competition between branded products and private label products.
  - NS2 by contrast allows for indirect competition between branded products and private label products.
  - NS2 and NS1 impose same type of constraints but in different directions.
  - Both of these nest structures have been assessed in order to allow for flexibility in consumer preferences and to avoid pre-determining ex-ante how closely consumers view private labels as substitutes to branded products.

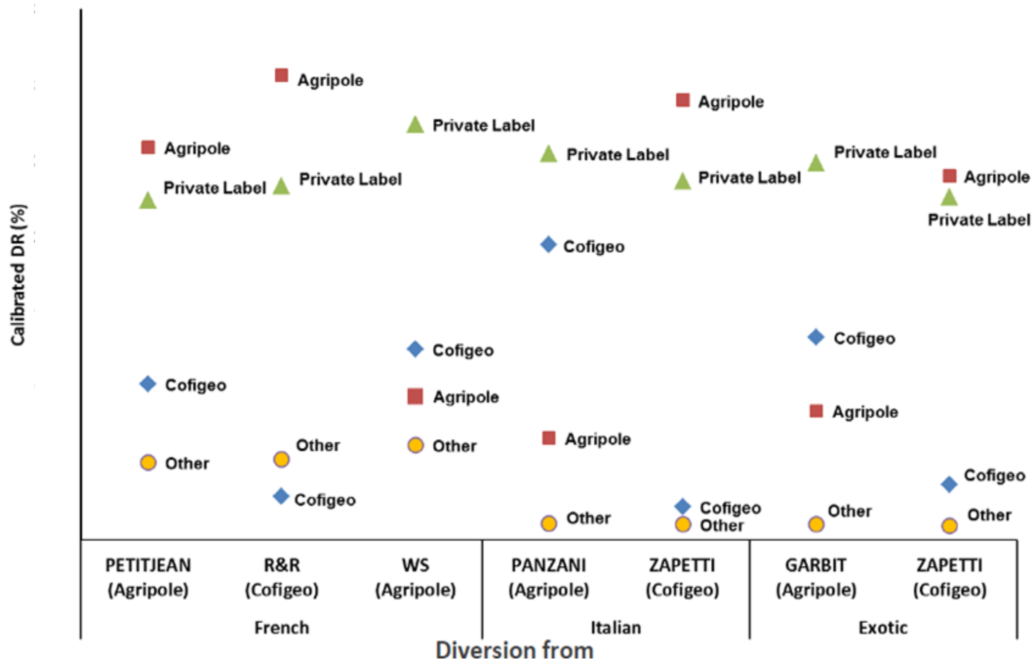
CLOSENESS OF COMPETITION

- The figures below set out a summary of simulated diversion ratios across the nest structures considered.

Simulated diversion ratios, NS1



Simulated diversion ratios, NS2



- We consider that private labels exert competitive pressure on branded products and that the Parties are not each other's closest competitors.
  - Simulated diversion ratios suggests that the Parties are not closest competitors when considering private labels.
  - Distributors survey rests on very fragile foundations.
  - Price differences cannot be used as a key criterion to define the relevant market.
  - Evidence of substitution between private labels and branded products (Kantar).

GUPPI

- The figures below set out a summary of GUPPI which are calculated using the simulated diversion ratios obtained from the nested logit merger simulations.

Prepared meals segment	Diversion	Compass Lexecon		FCA (based on survey)
		NS1	NS2	
PCF	Cofigeo > Agripole	[5-10]%	[5-10]%	[10-40]%
PCI	Cofigeo > Agripole	[10-15]%	[5-10]%	[15-40]%
PCE	Cofigeo > Agripole	[5-10]%	[5-10]%	[15-40]%
PCF	Agripole > Cofigeo	[0-5]%	[0-5]%	[15-40]%
PCI	Agripole > Cofigeo	[5-10]%	[5-10]%	[15-40]%
PCE	Agripole > Cofigeo	[0-5]%	[0-5]%	[15-30]%

- The possible effects of the Transaction estimated based on the FCA's survey of distributors are greatly overestimated. Based on our merger simulation model:
  - For three brands, GUPPIs estimated based on simulated diversion ratios are below the 5% threshold.
  - Only for one brand, the GUPPI exceeds the 10% threshold for only one brand, under NS1.

PRICE EFFECTS

- The figures below set out a summary of simulated price changes across the nest structures considered. The figures exclude potential variable cost synergies which may arise as a result of the merger.

Prepared meals segment	Diversion	Compass Lexecon	
		NS1	NS2
PCF	Cofigeo (R&R)	[5-10]%	[10-15]%
	Agripole (William Saurin)	[0-5]%	[0-5]%
	Overall market segment	**[0-5]%**	**[0-5]%**
PCI	Cofigeo (Zapetti)	[10-15]%	[10-15]%
	Agripole (Panzani)	[5-10]%	[5-10]%
	Overall market segment	**[5-10]%**	**[5-10]%**
PCE	Cofigeo (Zapetti)	[5-10]%	[15-20]%
	Agripole (Garbit)	[0-5]%	[5-10]%
	Overall market segment	**[0-5]%**	**[5-10]%**

- The above price effects may actually overestimate the actual price effects of the Transaction, for two reasons: (a) countervailing buyer power; and (b) conservative counterfactual scenario.

COUNTERVAILING POWER OF DISTRIBUTORS

- The simulated price effects are likely to be overestimated given distributors countervailing power.

- The combined entity would have been disciplined by the possible risks of retaliation in markets in which it would not enjoy a strong position post-Transaction.
  - Distributors could threaten to discontinue other products marketed by the combined entity (e.g. cooked vegetables) in response to a significant increase in prices for some or all of its PCA branded products.
    - There is evidence that discontinuation of certain products is used as a bargaining tool.
    - D'Aucy is a credible alternative supplier of cooked vegetables for distributors.

  - The incentives of the combined entity to increase prices of all or part of its branded PCA products must be assessed by comparing:
    - the possible incremental margin that would result from higher prices on all or part of PCA products; and
    - the total loss of margin on cooked vegetables that would result from retaliations by distributors.
    - The comparison of these two quantities cannot be deduced solely from a comparison of turnovers and margins conducted at a high-level.

  - We show that the possible unilateral effects arising from the Transaction for different PCA segments could be called into question after accounting for possible retaliation from distributors on cooked vegetables.

SKEWED COUNTERFACTUAL SCENARIO

- The merger simulation model evaluates the price effects of the Transaction by taking the pre-Transaction situation as a reference. The FCA considers that this is a reasonable benchmark as, absent the Transaction, Agripole's assets would have been taken over by a third party, [Candidate A] (active in the sector) or [Candidate B] (not active in the sector).

- We disagree and investigate different takeover scenarios (brands and/or assets) for [Candidate A], evaluating which one would be the more profitable.

- We show that [Candidate A] would have favoured partial takeover (only brands). The industrial production capacity in the market would thus be reduced compared to the pre-Transaction situation.

- The counterfactual situation would be *de facto* less competitive than the pre-merger situation could be, with higher prices.
  - Less production capacity would have been available for private labels;
  - Private labels would have exerted lower competitive pressure on the Parties' brands;
  - Absent the Transaction, prices would have been higher then the ones observed in the pre-Transaction situation.

- Therefore, the price differences between the situation with the Transaction and the counterfactual situation without the Transaction would not be lower than those predicted by the merger simulation exercise.

CONTACTS

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