

**COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA**

Case no.: 60/LM/Aug04

In the large merger between:

Pioneer Foods (Pty) Ltd

and

Golden Lay Farms Ltd, Golden Lay Farms KZN (Pty) Ltd, Golden Lay Foods (Pty) Ltd

Reasons

Introduction

On 29 September 2004 the Competition Tribunal unconditionally approved the acquisition of Golden Lay Farms Ltd, Golden Lay Farms KZN (Pty) Ltd and Golden Lay Foods (Pty) Ltd by Pioneer Foods (Pty) Ltd. The reasons for approving the transaction are set out below.

The transaction

Both companies are vertically integrated in the commercial egg industry. In terms of the transaction Pioneer Foods (Pty) Ltd ("Pioneer Foods") will acquire the following businesses from Golden Lay Farms Limited ("Golden Lay"):

- four Point of Lay hen rearing facilities,
- all its commercial egg layer farms,
- its egg packing stations, and
- its value added egg foods factory.

Golden Lay will exit the commercial egg market but will retain its day-old pullet business, as well as its Point of Lay hen rearing facility in KwaZulu-Natal, to become a specialized rearing firm producing pullets and Point of Lay hens.¹

Pioneer and Golden Lay also entered into a supply agreement in terms of which Golden Lay Farms would supply Pioneer Foods with day old pullets for a period of 5 years.

Rationale for the transaction

According to Golden Lay it wishes to focus its efforts and expertise on breeding poultry stock for the layer industry, rather than distributing commercial eggs to the retail market. Pioneer on the other hand wishes to expand its national market share in the production of commercial eggs.

Background on the commercial egg industry and the relationship between the parties

In South Africa there are two genetic breeds of chickens that lay eggs for the commercial market, Lohmann and Hyline. Both breeds are imported.

The Lohmann breed emanates from Europe and is imported by Lohmann SA, a joint venture between Pioneer Foods and Golden Lay Farms. Hyline is an American breed and is imported, solely, by Hyline SA.²

Lohmann SA imports the Lohmann genetic stock (known as grandparents) into South Africa as day old chicks. The grandparents are reared to lay eggs, which are incubated to produce day old chicks called parents. Lohmann SA then on-sells its production of parent stock to its joint venture owners, Pioneer Foods and Golden Lay.

Pioneer, through its Nulaid division, and Golden Lay each rear their parent birds independently. The eggs produced by the parents are incubated and the day-old chicks that hatch are called pullets.³ The pullets are then reared on rearing farms until they are mature at 21 weeks and are ready to lay commercial eggs, at

¹ According to Golden Lay it did not want to sell its KZN rearing facility because it is remote and free standing from its three other rearing facilities that operate as a single unit.

² Hyline SA only imports grandparents, rears them to breed parent stock which in turn produce hatching eggs for day old commercial layers. It sells all its day-old pullets to independent rearing farms and is not involved in rearing Point of Lay hens.

³ Term used by industry for day-old commercial layers.

which stage they are called Point of Lay hens.⁴ Commercial layers have a production lifespan of approximately one year after which they are culled. The whole production process, from grandparent stage to the culling of the point of lay hen, runs close to three years.

The relevant market

Three relevant markets were identified:

1. The national market for the rearing and sale of point of lay hens,
2. The commercial egg market, and
3. The regional liquid egg market.

Although both the Commission and the parties agreed on the relevant markets for the rearing and sale of Point of Lay hens and the liquid egg market, they disagreed on the relevant geographic market for commercial eggs.

The parties argue that the geographic market for commercial eggs is national, rendering Pioneer and Golden Lay competitors, while the Commission maintains that it is regional. As a result of the Commission's geographic definition Pioneer and Golden Lay do not compete in the same market.

We do not have to define the geographic market for purposes of this transaction since the merger will not, as set out below, substantially lessen or prevent competition in the commercial egg market, even if we define the market as national.

Effect on competition

We will consider the effect of the transaction on competition in the market for the Rearing and Sale of Point of Lay hens and the market for Commercial eggs.⁵

The market for the Rearing and sale of Point of Lay hens

Following the transaction the market shares of Nulaid and Golden Lay farms, in respect of the market for the Rearing and Sale of Point of Lay hens to the independent market, will change from 8% and 19% to 19% and 7%, respectively.

⁴ According to the parties, the majority of egg producers in South Africa rear their own Point of Lay hens as it is a very crucial phase in the life of the hen and the quality of the rearing process has a direct bearing on the efficiency with which the hen will eventually produce eggs during her laying phase.

⁵ Since the parties are not regarded as competitors in the market for liquid eggs the transaction will not affect competition in this market, see page 10 of the Commission's recommendation.

Golden Lay will not exit the market but will, together with Almur Smit with its market share of 51% and Eiken Hof with its market share of 10%, remain as one of four competitors. Even though Golden Lay concluded a supply agreement with Pioneer it would continue to supply independent egg producers with day-old pullets as well as Point of Lay hens.

The market for commercial eggs

Currently the main commercial egg producers are Golden Lay with a national market share of 8%, Eggbert with 6%, Highveld Coop with 10% and Nulaid with 19%. Post the transaction Nulaid's market share will increase to 27%. Independent farmers supply 50% of the commercial egg market.

We assessed the strength of competition in this market by taking into account the dynamic characteristics of the market, the ease of entry and the degree of countervailing power.

The timeline involved in the production process of commercial eggs is three years and as a result the size of the commercial egg production at any given time is established three years in advance.⁶ Eggs also have a shelf life of only 7 to 21 days. The net effect if this is that the commercial egg industry is cyclical by nature, meaning that, although demand may decrease or increase, supply remains relatively stable as a result of the lengthy production cycle.⁷ According to the parties this leads to severe cycles in terms of profitability - a small excess supply will lead to a rapid price decrease, and a small supply shortfall will be reflected in a rapid price increase. In order to manage this imbalance between supply and demand, producers determine the price of their commercial eggs weekly, on a Monday, by taking into account the number of eggs sold in retail stores during the previous week.

Entry into this market is relatively easy. The large presence of fairly small independent farmers in this market - they supply more than 50% of the commercial egg market - is evidence of the fact that it requires relatively little capital investment to establish production, grading and branding facilities.⁸ Moreover, although the large players mostly supply the large retail chains, some of the independent small farmers have, according to the parties, managed to secure supply contracts with retail outlets, including branches of the large chains.⁹

⁶ It takes producers 1 to 2 years to increase or decrease flock numbers, see page 14 of the transcript.

⁷ For instance, more eggs are sold during holiday period, resulting in an increase in demand, see page 15 of the transcript.

⁸ Most independent farmers do not grade their eggs while larger suppliers do. That is why the large retailers, inter alia, tend to buy from the large suppliers.

⁹ See page 12 of the transcript dated 29 September 2004.

The parties believe that the market for eggs in South Africa is mature and growth opportunities depend on increased consumption, due to egg prices or the prevailing health perception of eggs. They admit that large retailers prefer to stock graded eggs but say that they use the price of non-graded eggs to influence the price of graded eggs. According to them this provides retailers with countervailing power and would it not be possible for a single large supplier of graded eggs to dictate the price of graded eggs.

We therefore find that the merger would not substantially lessen or prevent competition in any of the relevant markets.

Public interest issues

The transaction does not raise any significant public interest concerns.

D Lewis

13 October 2004
Date

Concurring: N Manoim, M Mokuena