

OFFICE FOR COMPETITION

27 January 2016

COMP- MCCA/28/2015 – Acquisition of Nomar Distributors by Federated Mills plc (C15903)

Decision on acquisition in terms of regulations 6 (1) (ii) of the Control of Concentrations Regulations (LN 294 of 2002 as subsequently amended)

The Office for Competition,

Having considered the notification of 14 December, 2015 pursuant to regulation 5 of the Control of Concentrations Regulations,

Having considered the provisions of the Control of Concentrations Regulations (S.L. 379.08),

Whereas,

FACTS

1. On 7 December, 2015, Federated Mills plc (C15903) (hereinafter referred to as “the Notifying Party”) notified the Office for Competition (hereinafter referred to as “the Office”) whereby pursuant to a preliminary agreement for the transfer of assets dated 3 December 2015 and a draft contract of employment the Notifying Party will be purchasing the assets pertaining to Nomar Distributors (hereinafter referred to as “the Seller”).
2. The notification was filed on 7 December 2015, and accepted as a complete notification on 14 December 2015. It was notified to the public through a notice

that appeared in the Government Gazette number 19,514 of 18 December 2015 and a notice that appeared in a local newspaper on 18 December 2015.

A. PARTIES

3. The Notifying Party is a public limited company in Malta with company registration number C 15903 and registered office at Marsa Flour Mills, Kanċillieri Lane, Off Bridge Wharf, Marsa (MRS1402) Malta. The Notifying Party is the only flour milling company in Malta and its principal activity is the milling and sale of wheat flour and its by-products. The Notifying Party was incorporated in 1994 by virtue of an industry merger agreement between six family owned mills into one entity. Presently, the Notifying party imports all its wheat grain via large vessels from Europe and North America. The wheat grain is subsequently discharged and stored at Kordin Grain Terminal which is then transferred to the Notifying Party. This wheat is milled into flours of various specifications including among others, bakers' hard, soft, premium, confectioners' and wholemeal flour¹, as well as other related products, such as wheat bran and wheat pollard. The Notifying Party is also involved in the downstream supply of flour as it transports a proportion of its sales directly to the final customer through its own delivery network.

4. The Seller with VAT No. 1600-2304 MT and address at 32, St Mary Street, Għaxaq, is not a registered company. Operators of the Seller are self-employed and working as a partnership in the business of distribution of wheat flour and related products to the local market. Presently, the only supplier of wheat flour to the Seller is the Notifying Party.

B. THE TRANSACTION

5. Pursuant to the terms and conditions of the preliminary asset transfer agreement, the Notifying Party will purchase the assets of the Sellers as specified in the

¹ <http://www.fedmillsmalta.com/>

Agreement. The consideration for the assets and for the obligations undertaken by the Sellers according to the Agreement shall become due by the Notifying Party upon completion of the Agreement which is conditional upon approval of the said transaction by the Office for Competition. Pursuant to this concentration, a separate draft contract of employment was entered into between the Notifying Party and the Seller, whereby the Notifying Party also undertakes to fully employ the persons currently running the business of the Seller.

C. NOTIFIABLE CONCENTRATION

6. In terms of regulation 2 of the Control of Concentrations Regulations, a concentration, *inter alia*, refers to the acquisition by one or more undertakings or by one or more persons already controlling at least one undertaking whether by purchase of securities or assets, by contract or by other means, of direct or indirect control of the whole or parts of one or more undertakings.
7. The proposed transaction brings about the acquisition by the Notifying Party of sole control on the Seller in the form of purchase of assets.
8. Therefore, the proposed transaction constitutes a concentration within the meaning of regulation 2 of the Control of Concentrations Regulations.

D. THRESHOLD FOR NOTIFICATION

9. The aggregate turnover of the undertakings concerned in the preceding financial year exceeds €2,329,373.40 and each of the parties concerned had a turnover in Malta equivalent to at least ten per cent (10%) of the combined aggregate turnover of the undertakings concerned.
10. The notified concentration, therefore, meets the notification threshold as set out in regulation 2 of the Control of Concentrations Regulations.

E. THIRD PARTY OBJECTIONS

11. There were no Third Party Objections.

F. THE RELEVANT MARKET

12. The EC Commission's Notice on market definition states that, "a relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the end customer, by reason of the product's characteristics, their price and their intended use."² In addition, the Notice explains further that firms are subject to three core competitive constraints: demand substitutability, supply substitutability, and potential competition. Demand substitutability refers to the possibilities for customers to switch some of their purchases from the focal product to other readily available substitute products in response to hypothetical, small but permanent relative price increase in the focal product. Supply side substitutability occurs where in relation to a rise in relative prices, undertakings are able to switch production to the relevant products in a short term without incurring considerable additional costs. Potential competition is not analysed at the stage of market definition but is examined at a later stage when considering barriers to entry.

Market for the manufacture and importation of flour

13. The Notifying Party submitted that upstream, the relevant market is the market for the manufacture and importation of flour and related products within Malta. The Notifying Party operates on this market as a manufacturer, as it imports the primary product (i.e. wheat grain) and mills it into wheat flour. Imported flour is also classified within the same relevant market, as it is considered to be interchangeable with locally manufactured flour.

² Found at: [http://eur-lex.europa.eu/LexUriServ.do?uri=CELEX:31997Y1209\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ.do?uri=CELEX:31997Y1209(01):EN:HTML), paragraph 7

Market for the transportation of flour

14. The Notifying Party further submitted that downstream, the relevant market is the market for transportation of flour and related products within Malta. This is the market on which the Seller operates. The Notifying Party is already operating on this market. Importers of flour are also operating within this market and transport the imported flour products to their end customer.
15. Furthermore, the Notifying Party stated that locally, the supply of wheat flour heavily relies on importation (whether locally manufactured or imported as a final product), due to the fact that locally grown wheat is not suitable for milling into wheat flour. Thus the supply of flour in the Maltese market is determined by the following two activities:

i. Flour Manufacture & Transportation: The Notifying Party is the only wheat flour mill operating in Malta. The wheat imported from abroad, is milled and transformed into flours of various specifications and other related products, such as wheat bran and wheat pollard. The downstream supply chain of the Notifying Party is composed of its own transport network, other distributors (burdnara) including the Seller, and to customers using their own means of transport. From this it emerges, that that the Notifying Party and the Seller are involved and accordingly overlap in the transportation and distribution of manufactured wheat produced by the Notifying Party to their customers.

ii. Importation & Transportation: There are a number of import and distribution companies which import flour from flour mills in Europe through full container loads. They transport this flour directly to end-users. Besides these companies, there are a few bakeries which are also importing their flour requirements directly from abroad.

16. In view of the above, the Notifying Party submitted that both locally manufactured flour and imported flour should be considered to fall under one market, as these products are interchangeable. To determine the degree to which locally manufactured flour and imported flour are substitutable, the Office conducted a

number of meetings with both the main clients of the Seller and its main competitor. From the meetings, it emerged that both locally manufactured flour and imported flour are by and large of the same quality to an extent that no flour is considered as superior over the other, thereby concluding that locally manufactured flour and imported flour can be used interchangeably to produce the same end product.

17. Due to the fact, that the proposed acquisition will be taking place in the distribution and transportation sector, the Office has adopted a conservative approach and has considered the narrower market for the distribution and transportation of flour in Malta.

18. In conclusion, the Office has considered that in delineating the definition of the relevant product market, the transportation and distribution of both manufactured and imported flour is to be included in the same product market, owing to the fact that they are substitutable in terms of the quality of the flour.

Geographic market definition

19. The EC Commission`s Notice on market definition defines the relevant geographic market as “the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.”³

20. The Office considers that the relevant geographic market for the above mentioned products is the national territory of Malta. This is due to the fact that all suppliers of flour distribute their products across Malta without any differing conditions as to price and terms of sale.

³ Found at: [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209(01):EN:HTML), paragraph 8

21. In view of the above, the Office considered that that the geographic market is predominantly national.

Competitive Assessment

22. For the purpose of Section 6 III of the Concentration Notification Form (annexed to the Control of Concentrations Regulations), affected markets are relevant product markets where, in the Maltese territory or a relevant part thereof:

- a) Two or more of the parties to a concentration are engaged in business activities in the same product market and where the concentration will lead to a combined market share of 15% or more, or
- b) One or more of the parties to the concentration are engaged in business activities in a product market, which is upstream or downstream of a product market in which any other party to the concentration is engaged, and any of their individual or combined market shares is 25% or more, regardless of whether there is or is not any existing supplier customer relationship between the parties to the concentration.

Horizontal Overlaps

23. The activities of the involved parties overlap horizontally in the markets of:

- Transportation and distribution of flour (NACE Code 49.41 (4923) freight transport by road)

The horizontal overlap results from the fact that the Notifying Party also operates in the downstream market of distribution and transportation of flour and related products to the same extent as the Seller.

24. In assessing any competitive concerns in relation to the above mentioned markets in view of the proposed transaction, the Office will analyse the following pertinent key factors:

- i. Market Shares
- ii. Potential competition : Barriers to entry and Expansion

- iii. Countervailing buyer power
- iv. Access to other independent distributors
- v. Efficiency gains
- vi. Ancillary restrictions

Market shares

25. On the basis of the data submitted by the Notifying Party, market shares were estimated as provided in Table 1 below.

Table 1: Approximate market share of transportation only

		✂		
✂	✂	✂	✂	✂
✂				
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂				
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂
✂	✂	✂	✂	✂

*✂

26. It can be noted that the Notifying Party enjoys a strong position in the market. ✂

✕ The Office will proceed to analyse constraints that potential competitors may face, buyer power, access to the Notifying Party's products and efficiency gains to provide a more complete assessment of the proposed acquisition.

Potential Competition

- Barriers to entry

27. The Notifying Party and the Seller stated that barriers to entry are low, pointing to amongst others, the absence of regulatory constraints⁴ and the occurrence of entry and exit of distributors of flour in the past years.
28. The Office noted that barriers to entry in the transportation and distribution of flour do not seem very high. The only set up cost required is the financial commitments that need to be undertaken to purchase a delivery vehicle.
29. A barrier which emerged from the meetings held by the Office with the main customers of the Seller was customer loyalty. These customers explained that they have been in business for a long time and that that they were always highly satisfied with the service provided. Moreover, the Notifying Party was always willing to help when needed, thus the customers established a certain degree of loyalty towards their supplier. Ultimately these customers stated that what really matters is the quality of the supplied wheat flour, which according to them has been consistently good.
30. The barrier of customer loyalty could be overcome by the fact that differing prices for flour may play a determining factor of customer preference. The Notifying Party explained that customer loyalty is evident to some extent, however regularly compromised by the price factor as customers are likely to shift from one supplier to another based on the price factor.

⁴ Besides the standard regulatory requirements for the establishment and running of a food operation there are no legal or regulatory barriers

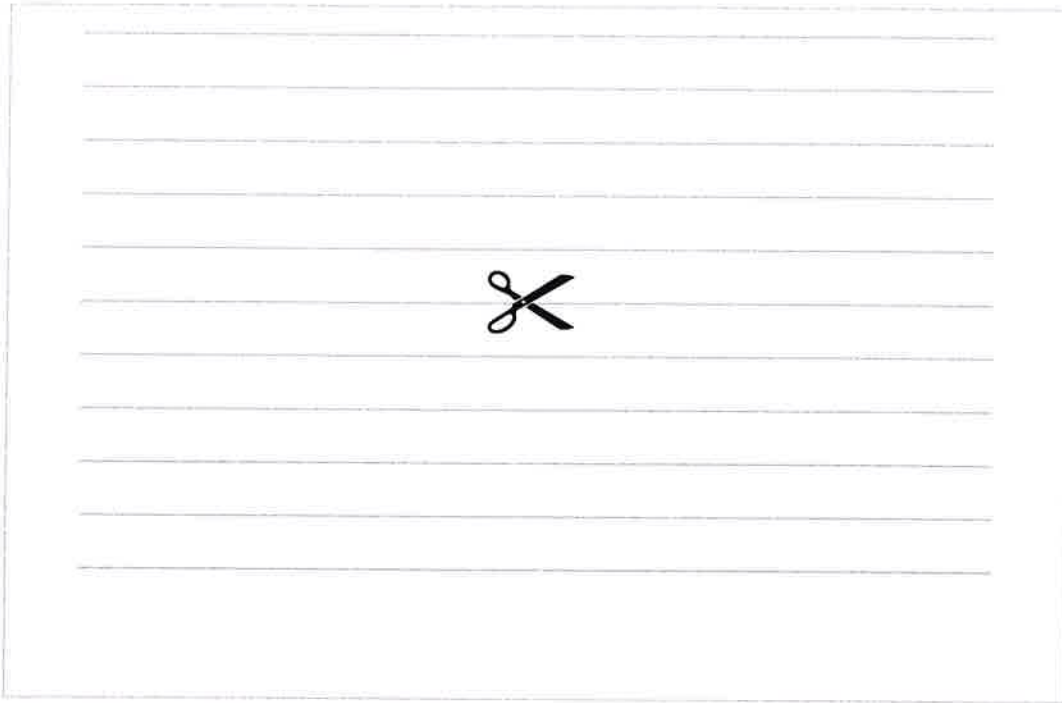
In view of the above, potential operators can enter the market and the likelihood of new entrants for the importation and transportation of flour is possible.

- **Expansion**

31. As mentioned above, there are clearly low barriers to entry and this market is easily accessible by potential distributors. The Notifying Party submitted that the flour industry in Malta is considered to be in a mature stage within the product life cycle. By looking at the demand for flour in Malta for the past 10 years, presented in Table 2 below, the Office observed that the demand has been stable over the years.

Table 2: Demand for Flour in Malta

*
**



✂

32. While the imported flour is experiencing an increasing demand, the manufactured flour is facing a declining demand. This continues to strengthen the argument, that the imported flour is a sufficient substitute to the manufactured flour in Malta and that presently the Notifying Party is facing strong competition.
33. Wheat flour is a basic commodity used in the manufacture of staple products (mainly bread) and there are no significant growth forecasts, in terms of future demand. This suggests that demand volumes are expected to remain relatively stable.
34. In view of the above, an efficient operator has to source additional clients from those of already established distributors. This is because the market at this stage is saturated where further growth seems to be limited.

Buyer Power

35. In the market for the transportation and distribution of flour, the Notifying Party will also not be in a position to significantly impede effective competition, in particular by acting to an appreciable extent independently of its customers as the latter possess countervailing buyer power.

36. This is due to the fact that buyer power exerted on wheat flour suppliers is a significant, strong and extremely important factor when planning strategic direction within the industry. Customers, such as, bakers can easily resort to another supplier as switching costs for most of these customers are relatively low. Due to the bulky nature of the goods as well as product quality reasons, customers tend to hold limited stocks in their factories or bakeries. Thus they can readily switch between suppliers.

37. A strong buyer power is also exemplified by the fact that some of the smaller bakeries are regularly buying flour supplies from more than one supplier at the same time. This enables switching between suppliers.

38. The Office concluded that the extent of buyer power, at the end is proportional to the volumes of flour consumed by the particular customer.

Access to other independent distributors

39. The Office also considered whether the Notifying Party would foreclose other independent distributors. The Office noted that the Notifying Party wants to maintain its current market position, thus it is unlikely that the Notifying Party would refrain from supplying flour to third parties.

40. In view of the foregoing, it was concluded that the concentration would not lead to any foreclosure of independent distributors, by reducing or limiting access to the Notifying Party's products.

Efficiency gains

41. The Office noted that to further assess the competitive impact of the proposed concentration, it is appropriate to consider any substantiated and likely efficiencies brought by this acquisition since it is possible that the efficiencies will counteract any *prima facie* competitive concerns.

42. Efficiencies have to be beneficial to the end consumer and verifiable. The relevant benchmark in assessing efficiency is that consumers will not be worse off as a result of the acquisition.

43. The Notifying Party submitted that through the proposed concentration, it will be integrating and managing two distributions routes, (that are currently operating independently of each other), each supplying customers with bulk and bagged wheat flour. The efficiency gains of such integration are related to an improved logistics of supply. According to the Notifying Party, economies of scale are also expected to improve post- acquisition due to, *inter alia*, increased transportation volume thus contributing to further efficiency gains.

44. Additionally, the resultant benefits of this acquisition will be passed onto the consumer in terms of technical expertise of the Notifying Party and a more efficient transportation system, among others, thus leading to a better service to the customer.

45. In view of the above, the Office is satisfied that this acquisition results in efficiency gains.

G. ANCILLARY RESTRICTIONS

46. The Notifying Party submitted that a contractual obligation exists in the preliminary asset transfer agreement that it considers to be directly related to and necessary for the implementation of the concentration. This relates to a three year non-compete obligation clause on the Seller. The Notifying Party submitted that this clause is necessary since the representatives of the Seller will become full-time employees with the Notifying Party post-acquisition. The Notifying Party further submitted that the purpose of the non-compete clause is to further ensure that the representatives of the Seller are fully committed to their employment with the Notifying Party. The Office considered this restriction as directly related to and necessary for the implementation of the concentration and is therefore cleared by this decision.

H. CONCLUSION

47. In view of the above analysis the Office considers that due to the low barriers to entry in the market for the transportation and distribution of flour and the significant countervailing buyer power of its customers, the proposed transaction is unlikely to raise competition concerns. In addition, the efficiency gains brought about by the acquisition will outweigh any *prima facie* competitive concerns.

48. Although post-transaction the Notifying Party will have a high market share, this concentration will only aid in preserving the Notifying Party's market position as the latter is still facing strong competition from other leading competitors in this market. This ensures a competitive balance in the supply of flour as a valuable commodity.

DECISION

For the abovementioned reasons and in terms of regulation 6 (1) (ii) of the Control of Concentrations Regulations, it is therefore decided:

- (1) that the Concentration falls within the scope of the Control of Concentrations Regulations;
- (2) that the Concentration does not raise serious doubts as to its lawfulness;
- (3) not to oppose the notified Concentration and to declare it a lawful Concentration.



Godwin Mangion
Director General (Competition)

