



COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: LM237Feb16

In the matter between:

AFGRI Operations Limited

Acquiring Firm

And

Pride Milling Company (Pty) Limited

Target Firm

Panel	:	Yasmin Carrim (Presiding Member), Andiswa Ndoni (Tribunal Member) and Imraan Valodia (Tribunal Member)
Heard on	:	13 July 2016
Order issued on	:	13 July 2016
Reasons issued on	:	11 August 2016

Public Reasons for Decision

Conditional approval

- [1] On 13 July 2016, the Competition Tribunal ("Tribunal") approved the proposed transaction between AFGRI Operations Limited and Pride Milling Company (Pty) Ltd, subject to conditions.
- [2] The reasons for the conditional approval of the proposed transaction follow.

Parties to the Transaction

Primary acquiring firm

- [3] The primary acquiring firm is AFGRI Operations Limited ("AFGRI"), a company incorporated in terms of the laws of the Republic of South Africa ("RSA").

- [4] AFGRI is controlled by AFGRI (Pty) Ltd, which in turn is controlled by AFGRI Holdings (Pty) Ltd ("AFGRI Holdings").¹ AFGRI controls a number of firms (the companies within AFGRI that are incorporated in RSA will be referred to as the "AFGRI Group").

- [5] The AFGRI Group of companies provide a diverse and integrated range of products and services through four focussed operating divisions, namely: AFGRI Agri Services, AFGRI Financial Services, AFGRI Foods and AFGRI Investments. The AFGRI Agri Services and AFGRI Financial Services divisions are relevant for the current analysis as the operations under these divisions overlap with those provided by Pride Milling.

- [6] AFGRI Agri Services comprises of divisions that serve the primary agricultural production sector with a specific focus on the maize value chain from land preparation, seeds and other inputs, harvesting, grain procurement and storage. Other divisions of AFGRI Agri Services include: AFGRI Equipment which provides a range of equipment, products and services that are available through AFGRI's network; AFGRI Grain Management which offers storage of agricultural products, grain handling and procurement services; Collateral Management International business provides collateral and stock monitoring services to agribusinesses; and Hinterland which is a joint venture between AFGRI and Senwes which comprises of their respective retail stores and the related wholesale businesses.

- [7] AFGRI Financial Services provides financial and credit facilities to customers that operate in the agricultural sector through three business units: GroCapital which provides specialised finance to businesses involved in the agricultural

¹ Please note that AFGRI has claimed confidentiality over their group structure.

value chain; the UNIGRO Financial Services which acts as an originator and administrator for the Land and Agricultural Development Bank of South Africa ("Land Bank") in the extension of agricultural credit to primary producers of agricultural products; and the UNIGRO Insurance Brokers provides risk solutions and insurance.

- [8] AFGRI Foods comprises three divisions, namely: the AFGRI Animal Feed division that converts raw grain and other key elements into balanced feed for the livestock and dairy industries; Nedan, the oil extraction and protein plant which processes oil and raw material into edible oil, fats and high protein textured vegetable products for the food processing and animal feed industries; and AFGRI Milling which comprises of three yellow maize mills in Mpumalanga which produce yellow maize grits that are used in the production of various maize-based value-added products for human consumption such as cereals, crisps and thickeners.
- [9] AFGRI Investment offers agricultural support services in the areas of retail and commodity brokerage and shipping through its three business units: GROCAT which sells and distributes diesel, coal and other commodities to agricultural customers; Prodist which is a wholesale distributor of agricultural requirements, hardware, general merchandise and irrigation, focused on the development of an efficient channel of supply into the agribusiness and hardware retail store markets in South Africa and neighbouring countries; and GeoAgro which offers farmers the opportunity to enhance their farming operations through technology.

Primary target firm

- [10] The primary target firm is Pride Milling Company (Pty) Ltd ("Pride Milling"), a company incorporated in terms of the company laws of RSA. Pride Milling is jointly controlled by two individuals. Pride Milling does not control any firm.
- [11] On 1 August 2001, Pride Milling was established by acquiring the maize milling business of AFGRI, which consisted of white maize milling plants and yellow maize milling plants exclusively operated by AFGRI. In August 2011, AFGRI repurchased its yellow maize milling business from Pride Milling

(hereinafter referred to as the "2011 Yellow Maize Acquisition") and thus Pride Milling retained the white maize milling operations.

- [12] Pride Milling owns and operates three white maize mills of which one is located in Nigel in Gauteng and two located in Ogies and Devon in Mpumalanga. Pride Milling is principally involved in the milling of white maize for the production of staple food products for human consumption (e.g. white maize meal) as well as hominy chop.² Pride Milling also owns and operates a food and feeds mill that manufactures and packs a range of grains, beans and pulse related products.

Proposed Transaction

- [13] AFGRI intends to acquire all the issued share capital of Pride Milling and its business as a going concern. Post-merger, AFGRI will have sole control over Pride Milling.
- [14] According to the Draft Sale of Shares and Claims Agreement ("Draft Agreement"), the proposed transaction will be implemented in two (2) stages: the first stage involves AFGRI acquiring an initial number of shares in Pride Milling ("the Tranche A Sale") and the second stage involves AFGRI acquiring the remaining shares in Pride Milling ("the Tranche B Sale"). According to the Draft Agreement, Tranche A Sale and Tranche B Sale will not take place simultaneously (the date on which the Draft Agreement stipulates that the Tranche B Sale will take place will be referred to as the "Tranche B Effective Date"). The merging parties testify that the rationale for structuring the deal in 2 steps is for the calculation of the transaction price for the Tranche B Sale and that it is unlikely that the Tranche B Sale will not occur for whatever circumstances that occur after the Tranche A Sale.
- [15] The merging parties submit that the two stages are indivisible and constitute a single transaction and that AFGRI will exercise control over Pride Milling in terms of section 12(2)(g) of the Competition Act 89 of 1998 ("the Act")

² Hominy chop is a by-product produced as a result of the maize milling process that is mainly used as a feed supplement at feedlots and in the manufacturing of animal feeds as an input. Millers sell hominy chop to generate a supplementary income stream.

following the implementation of the Tranche A Sale. It must be noted that this assertion is based on a draft and not a final agreement.

[16] The Commission is of the view that the two stages are divisible and that the Tranche B Sale is a separate transaction which constitutes an acquisition of control in terms of section 12(2)(a) of the Act. The time period between the Tranche A and Tranche B Effective Dates is significant (more than 12 months), and any extension of the period would warrant further investigation by the Commission. Thus the implementation of the Tranche B Sale may trigger a separate notification in terms of section 13A of the Act, as AFGRI will "cross the bright line". The Commission proposed the institution of Conditions to this transaction in order to guard against these risks.

[17] The Commission agreed with the merging parties that the proposed transaction be approved subject to the Conditions. At the hearing the Tribunal amended the wording of these Conditions to ensure that they are clear. The Merging Parties shall:

- a. Submit a copy of the Final Sale Agreement within 10 (ten) Business Days following final signature by the Merging Parties.
- b. Advise the Commission of the implementation of the Tranche B Sale should they implement the Tranche B Sale on or before the Tranche B Effective Date.
- c. Submit a notification in terms of section 13A of the Competition Act, should the Tranche B Sale be implemented after the Tranche B Effective Date.

Rationale

[18] Upon implementation of the 2011 Yellow Maize Acquisition, AFGRI re-entered the maize milling market but only as a yellow maize miller. AFGRI now wants to re-acquire the remaining Pride Milling mills as it wishes to re-enter the white maize milling market to expand its operations in the downstream processing sector for agricultural products by utilising the proximity of Pride Milling's mills to AFGRI's geographic area of operation.

[19] The proposed transaction presents an opportunity for the owners to realise their investment.

Impact on Competition

Horizontal assessment

- [20] Pride Milling is a white maize miller that produces maize products for human consumption whereas AFGRI is a yellow maize miller that produces maize grits that are used as inputs in the production of animal feed and products for human consumption. All yellow and/or white maize mills produce hominy chop as it is generated as a by-product of the maize milling process – therefore both AFGRI and Pride Milling are suppliers of hominy chop.
- [21] Although the Commission found that the markets for yellow maize and white maize are separate markets, the Commission identified the relevant market as the market for the production and supply of hominy chop, where there is a horizontal overlap in the activities of the merging parties in that market. The Commission found that hominy chop produced from yellow maize and white maize is substitutable on the supply-side because the machines used by yellow and white maize millers are the same; and on the demand-side based on the views of customers that the different value of hominy chop produced from white and yellow maize is not a factor in their purchasing.³
- [22] In determining the appropriate geographic market, the Commission considered a narrow market within a radius of approximately 300 kilometres (“km”) of Pride Milling’s mills in an area that includes mills plants in Mpumalanga and Gauteng. The narrowness of the market is largely due to the short shelf life of hominy chop making it imperative to supply within a localised area to avoid the product from degrading and to reduce transportation costs. There is a geographic overlap in the activities of the merging parties.
- [23] The Commission received concerns from [REDACTED], a competitor of the merging parties in respect to yellow maize milling (competing directly with AFGRI) and in the supply of hominy chop (competing

³ There are small differences in the prices of yellow and white maize chop, due to the differences in grading and energy content and the availability and demand for yellow and white maize in the market at any point in time.

with both AFGRI and Pride Milling). [REDACTED] submits that the merged entity might have significant market share post-merger which will enable the merged entity to engage in unilateral conduct by dictating the price of hominy chop post-merger. The Commission found that the merged entity will have a post-merger market share of 17,2% in the defined geographic market.⁴ Pioneer Foods (Pty) Ltd ("Pioneer") (35,3%) and Premier FMCG (Pty) Ltd ("Premier Foods") (21,7%) have higher market shares than the merged entity and are likely to continue to constrain the merged entity post-merger. The Commission further notes that there are many smaller competitors that supply hominy chop in the market and that any yellow or white maize mill that processes maize can produce and supply hominy chop. In addition, none of the customers identified by the merging parties raised concerns with the proposed transaction and the customers stated that they have more than one supplier of hominy chop at any given point in time as their required hominy chop cannot be sufficiently met by one supplier. Therefore, the Commission is of the view that the merged entity is unlikely to have the market power to engage in unilateral conduct post-merger. The Tribunal therefore concludes that the proposed transaction will not substantially prevent or lessen competition in the horizontal market

- [24] Against the backdrop of the history of collusion in the market the Commission considered whether the proposed transaction is likely to facilitate coordinated conduct in the market for the supply of hominy chop post-merger. In this regard the merging parties have been implicated in a number of cartel investigations and have been fined by the Tribunal under section 59 of the Act for conduct in contravention of section 4 of the Act.⁵

⁴ Based on volume sales supplied by the market participants for 2015.

⁵ See *Paramount Mills (Pty) Ltd v The Competition Commission In the matter between: The Competition Commission v Pioneer Foods (Pty) Ltd And 16 Other Respondents 15/CR/Mar* where Pride Milling was implicated for price fixing in the white maize milling industry and settled with the Commission to pay an administrative fine (AFGRI was not implicated in the cartel); *The Competition Commission v AFGRI Operations Limited and 16 Other Respondents 43/CR/Jun11* where AFGRI was implicated in a cartel that fixed the tariffs for silo storage and settled with the Commission to pay an administrative fine (Pride Milling was not implicated in the cartel); the Commission initiated a complaint relating to possible collusion in the bran and hominy chop markets on 22 April 2010 implicating both Pride Milling and AFGRI but this was not referred for prosecution due to lack of evidence. The Commission did not find any cases where AFGRI and Pride Milling were implicated for coordinated conduct in respect to the supply of hominy chop.

- [25] The Commission found that the market conditions are conducive for collusion by identifying the structural features of the market. The structural features identified include that hominy chop can be regarded as a homogenous product; barriers to entry appear to be high in the market; and competitors regularly interact in other geographical and products markets. At the same time the Commission noted that the large number of firms active in the market and the asymmetry in the market shares amongst competitors is not conducive for coordinated conduct.
- [26] The Commission argued that it is unlikely that market participants will be able to find a suitable and sustainable collusive mechanism in the market. The prevailing market conditions making this unlikely include: the price of hominy chop which is calculated on the basis of the price of maize that is set on a common, publically available, reference index for white and yellow maize (the South African Futures Exchange Division [SAFEX]);⁶ the fragmented market; the short shelf life of the product; the fact that the product is a secondary by-product; and that the high demand for hominy chop cannot be met by any single supplier.
- [27] In light of the above the Tribunal concluded that the merger does not increase the likelihood of co-ordination post-merger.

Vertical assessment

- [28] The Commission found that there are six services and/or products that the merging parties procure from each other. The Commission did not assess the vertical overlap in the markets for the grain screening services Pride Milling provides to AFGRI and in grain trading where AFGRI sells maize to Pride Milling because the proposed transaction is unlikely to raise foreclosure concerns in these markets.⁷ The Commission looked at the following markets:

⁶ The price of hominy chop is set between 80 and 85% of the SAFEX price for maize and the industry regards this as the competitive norm price. The price determined by SAFEX is dependent on the grading of the maize (which is based on nutritional value and energy content) and the merging parties attested that they do not have the power to change the SAFEX price. If the merging parties charged a price above the competitive norm, customers would substitute hominy chop with maize – suggesting that hominy chop suppliers have no incentive to raise hominy chop prices above 85% of the SAFEX maize price.

⁷ In the grain screening market the merging parties provide these services exclusively to each other and not to any third parties. In the grain trading market the market is fragmented, constraining the merged entity.

(a) The market for the supply of cattle and sheep feed in South Africa and within Gauteng and Mpumalanga

- [29] In the upstream market for the production and supply of hominy chop, Pride Milling supplies hominy chop to AFGRI to use as an input to produce animal feed which it supplies in the downstream market for the production and supply of cattle and sheep feed.
- [30] In assessing the likelihood of input foreclosure post-merger, the Commission found that hominy chop is substitutable as an input for the production of animal feed. The Commission also found that Pride Milling does not supply hominy chop on a sustained, regular basis to AFGRI or any other animal feed manufacturers that compete with AFGRI. These factors indicate that the merged entity does not have the ability and incentive to engage in input foreclosure.
- [31] The Commission found that the downstream market is fragmented and that AFGRI has approximately 1% market share in the market for the production of cattle and sheep feed.⁸ AFGRI also does not purchase chop from Pride Milling or any other mills on a sustained, regular basis, as it currently fulfils nearly all of its maize input requirements from its own maize processing plants in the region; AFGRI only purchases chop from Pride Milling when it is available at an attractive price (relative to other substitutes). Therefore AFGRI does not have sufficient market power to engage in customer foreclosure.

(b) The national market for the production and distribution of white maize milled products

- [32] In the upstream market for the production and supply of white maize products, Pride Milling mills white maize to produce maize products and in the downstream market for the retail of white maize products, AFGRI owns retail stores which sell maize products.
- [33] The Commission found that Pride Milling will continue to face competitive constraints from other large millers such as Pappas, Premier Foods, Tiger

⁸ Based on the sales volumes published by the Animal Feed Manufacturers Association during the 2014/2015 financial year.

Consumer Brands Limited ("Tiger Brands") and Pioneer Foods. The merged entity will therefore not have the ability to engage in input foreclosure conduct.

- [34] In the downstream market for the retail of maize, the Commission finds that there are a number of alternatives which include established retailers such as Spar Group Limited, Shoprite Holdings Limited, Massmart Holdings (Pty) Ltd and Pick 'n Pay Retailers Limited that will constrain the merged entity post-merger. The Commission found that none of the competitors in the downstream market identified AFGRI as a significant purchaser of these products and as such did not raise any concerns with the proposed transaction. Therefore, the Commission is of the view that the proposed transaction is unlikely to lead to customer foreclosure concerns in the market, as the merged entity will have no incentive to cease supplying these products to other purchasers and current customers of Pride Milling.

(c) The provision of retail lending in South Africa

- [35] AFGRI supplies retail lending to agri-businesses such as Pride Milling.
- [36] The Commission found that AFGRI does not have market power, as it holds approximately 10% of the market and continues to face a competitive constraint from financial institutions with large scale finances such as the Land Bank (26,9% market share), ABSA Bank Limited (28,9%) and Standard Bank of South Africa Limited (14,5%) and any of the other financial service providers.⁹ The Commission is of the view that AFGRI would not have the ability or incentive to engage in input foreclosure as Pride Milling contributes an insignificant portion to its financial services business and there are viable alternative suppliers. There are also many other agribusinesses in the market which providers of retail lending competing with AFGRI can continue to supply post-transaction, meaning that it is unlikely that customer foreclosure would occur.

(d) The provision of grain storage facilities (silos) within the 60 kilometre radius of AFGRI's silos

- [37] AFGRI provides grain management service – which include grain storage and handling services – to customers such as Pride Milling in commercial silos.

⁹ Based on the Commission's findings on case LM226Feb16.

Customers tend to store their grain in the closest silo and do not want to travel far for the risk of losing their crop. The Commission is of the view that the effects of the proposed transaction are likely to be local as Pride Milling uses the adjacent AFGRI silos to store its maize.

[38] AFGRI is the only silo operator in the geographic market, making it dominant and able to engage in input foreclosure conduct post-merger. The Commission found that AFGRI is unlikely to have an incentive to engage in foreclosure conduct post-merger as Pride Milling uses less than 5% grain storage space in AFGRI's silos.¹⁰ It would therefore not be profitable for AFGRI to foreclose other customers that utilises 95% of their grain storage facilities in favour of Pride Milling.

[39] The Commission also found that Pride Milling only stored grain in AFGRI's silos in the last 24 months. Pride Milling is an insignificant customer of AFGRI, therefore the proposed transaction is unlikely to raise customer foreclosure concerns.

(e) Conclusion

[40] Pride Milling and AFGRI have a long history and close relationship, given that Pride Milling was historically owned by AFGRI prior to it selling Pride to its current shareholders. Accordingly, to the extent that Pride Milling has needed products and services which AFGRI supplies to agribusinesses in South Africa, Pride has typically turned to AFGRI as a supplier. The proposed transaction is, therefore, unlikely to result in any customer foreclosure concerns for competitors of AFGRI in the supply of these products and services in the market, as Pride is typically already procuring these products and services from AFGRI.

[41] The Tribunal concluded that the merged entity does not have the incentive in any of the markets to raise any input or customer foreclosure concerns. The transaction will, therefore, not result in any substantial prevention or lessening of competition in the vertical markets identified.

¹⁰ Based on the Commission's findings.

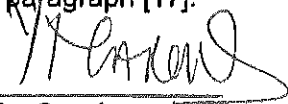
Public interest

[42] The proposed transaction is unlikely to raise employment concerns, as AFGRI is acquiring the Pride Milling's operations with the employees and intends to operate Pride Milling's operations as they are operating pre-merger.

[43] The proposed transaction further raises no other public interest concerns.

Conclusion

[44] In light of the above, we concluded that the proposed transaction is unlikely to substantially prevent or lessen competition in any relevant market. In addition, no public interest issues arise from the proposed transaction. Accordingly, we approved the proposed transaction subject to the conditions outlined in paragraph [17].



Yasmin Carrim

10 August 2016
DATE

Andiswa Ndoni and Imraan Valodia concurring

Tribunal Researcher: Derrick Bowles assisted by Thalalolwazi Msutu
For the merging parties: Shawn van der Meulen of Webber Wentzel
For the Commission: Dineo Mashego