COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 017459

In the matter between:

Afgri Operations Ltd	Acquiring Firm
And	
MGK Operating Company (Pty) Ltd	Target Firm

Panel	:	Takalani Madima (Presiding Member) Medi Mokuena (Tribunal Member) Mondo Mazwai (Tribunal Member)
Heard on	:	07November 2013
Order issued on	:	07 November 2013
Reasons issued on	:	27 November 2013

Reasons for Decision

Approval

[1] On 07 November 2013 the Competition Tribunal ("Tribunal") approved without condition the merger between Afgri Operations Ltd ("Afgri") and MGK Operating Company (Pty) Ltd ("MGK"). The reasons for approval follow below.

The Transaction

[2] The primary acquiring firm is Afgri, a company incorporated in South Africa and controlled by Afgri Limited with an outright majority shareholding. The residual shareholding in Afgri is held by Izitsalo Employee Investments (Pty) Ltd.[1] Afgri Limited is listed on the Johannesburg Securities Exchange Ltd ("JSE") and has various shareholders, five of whom have a shareholding in excess of 5%. In total these five shareholders own approximately 45% of Afgri Limited, and it follows that no single shareholder holds a controlling interest.[2]

[3] The primary target firm is the grain and oilseed silo business of MGK. MGK is wholly owned by MGK Business Investments which itself is listed on the JSE and has various shareholders; the four largest shareholders together hold approximately 90% of MGK's total shares, however, no single shareholder holds an outright majority interest.[3]

[4] Afgri, Afgri Limited, MGK, and MGK Business Investments each individually control various other firms.[4]

The Transaction

[5] Afgri is acquiring the silo business of MGK. This includes the fixed and movable assets as well as the rights and obligations relating to MGK's grain and oilseed silo storage business operations located at Northam, Brits, Pretoria West and Battery. Afgri will be wholly acquiring all these assets, rights and obligations save for the silos themselves. The four silos owned by MGK in the four previously identified locations will be leased to Afgri for an initial period of 9 years and 11 months with the option to renew the lease for additional 9 years and 11 months.

[6] The rationale for the transaction by MGK is that it wishes to exit the silo and grain business due to poor financial performance stemming from

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[1]See section 1.1 on page 7 of the Commission's report for specific details.
[2]See section 1.1 on page 7 of the Commission's report for specific details.
[3]See section 1.2 on page 8 of the Commission's report for specific details.
[4]See sections 1.1 and 1.2 on pages 7 and 8 of the Commission's report, Afgri's CC4(2) form at pages 11 and 12 of the record, and MGK's CC4(2) form at pages 25 and 26 of the record.

an inability to achieve economies of scale.[5] It therefore put the silo business on tender. Afgri, who has a strategy to expand the geographic reach of their businesses, was the successful bidder. The acquisition of the MGK silo business would save Afgri from having to build a bunker in Randfontein as well as giving them strategic entry opportunities for other Afgri businesses in the MGK region.[6]

[7] The transaction, in the Sale of Business Agreement,[7] includes a restraint of trade on MGK. The restraint was argued to be an integral component of the transaction and necessary for Afgri to recoup a return on its investment. The Commission found the restraint to be a common garden variety restraint necessary to protect the goodwill of the acquired business due to its limited nature in duration, geographic coverage and products/services.[8]

The relevant market

[8] The merging parties argued that various means of storing commodity products such as silo bags, famers' own silos, and the mills' silos all competed with the commercial silos of MGK and Afgri. The Commission, based on extensive anecdotal evidence and inferential reasoning, concluded that the constraining power of these alternative commodity storage facilities is weak and may be limited to certain time periods. The Commission thus took the conservative approach and excluded these alternatives from the product market leaving only commercial silo providers as competitors.

[9] The analysis evaluating this merger's potential to prevent or lessen competition, given the history and competitive dynamics of this market, is the same irrespective of whether the wider or narrower definition is

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[5]See section 2.2 on page 9 and 2.2.2 on page 11 of the Commission's report, the Genesis Report at page 52 of the record, and the Paper for Afgri Board Meeting at pages 378 to 382 of the record.
[6]See section 2.2.1 on page 10 of the Commission's report, and the Afgri Due Diligence at pages at pages 356 to 369 of the record.
[7]Item 81 on pages 790 to 836 of the record.
[8]See pages 8 and 21 of the transcript

adopted. For this reason, we have left the product market definition open for the purposes of this decision.

[10] Both the Commission and the merging parties use previous Tribunal decisions[9] to estimate catchment areas for grain storage silos of between a 40km and 60km radius. Both the Commission and the merging parties use the average radius of 50km for illustrative purposes, however, observe that their conclusions remain the same for radii of 40km or 60km.

[11] As with the product market definition, we do not find it necessary to conclude on an exact geographic market definition for the purposes of this decision. Rather, we define the geographic market as a radius between 40km and 60km around a silo.

Analysis of possible anti-competitive effects.

[12] The history and concentration in this industry together with vertical integration of some activities made it necessary for the Commission to investigate unilateral, coordinated and vertical theories of harm.

[13] During the regulated era the cooperatives were allocated certain geographic territories in South Africa. The deregulation and subsequent commercialisation of these cooperatives introduced competition at the trader level of the market however, because of the large capital costs and lack of mobility of commercial silos, the territories of silo operators have effectively remained unchanged.[10] Afgri's silos are located in western KwaZulu Natal, central and eastern Free State, Mpumalanga, southern Limpopo and eastern Gauteng (the "Afgri region"). MGK silos are located in the south west of Limpopo, north east of the North West Province and the north western region of Gauteng (the "MGK region").[11]

[9] In Afgri/NatalAgri the radius was 40km, and in Senwes the Radius was 60km.
[10] See page 14 of the transcript
[11] See Figure 1 of the Genesis report at page 61 of the record.

[14] The Afgri and MGK regions do not overlap with one another directly, but there may be some customers who could travel to either an Afgri or an MGK silo. The cost of transporting grain means that potential competition between Afgri and MGK for customers can only take place at the frontier dividing these two regions and not in the hinterlands of these regions. This frontier exists in the area between Afgri's silos in the east of Gauteng and MGK's silos in the west of Gauteng and east of the North West (although this silo in Brits does not overlap much with Afgri silos).[12]This frontier area between the Afgri region and the MGK region has two pertinent features: it is largely urban and is divided by the Johannesburg-Midrand-Pretoria strip; and, it contains the Randfontein area.

[15] The urban strip between the Afgri and MGK regions increases the transport costs between these two regions. This creates a disincentive for farmers to transport crops grown in one region across the urban strip in order to store it in the opposite region. The urban strip also means that the land in the overlap area is largely used for non-agricultural purposes. This means that any geographic measure of the overlap between the two regions will overstate the true overlap of customers.

[16] The relevance of the fact that Randfontein is located in the area between the Afgri and MGK regions is that the majority of grain customers (the mills) are located in this area. In the same way that rainwater flows down the two opposite banks of a valley into the river dividing the valley, crops produced in the west of Randfontein flow through the MGK silos towards Randfontein and crops produced in the east of Randfontein flow through the Afgri (and Senwes) silos towards Randfontein. Were grain grown in the Afgri region to be stored in an MGK silo, it would mean transporting the grain from the farm of production, past the ultimate end customer (the mill) to a silo for storage, and then ultimately backtrack again to the end customer in

[12]See Figure 2 on page 36 of the Commission report.

Randfontein on delivery date. The same logic holds true for grain grown in the MGK region being stored in the Afgri region. This would result in logistical inefficiencies which would be significant given the size of transport costs relative to the value of the product.

[17] Linked to, and reinforcing this previous transport argument for a lack of competition between regions, is the manner in which the South African Futures Exchange ("SAFEX") determines its geographic pricing points. SAFEX uses nodal pricing and calculates prices at each silo emanating out from the node by subtracting the SAFEX transport differential. This transport differential is calculated to approximate the actual transport costs from the silo to the node. The relevant node for the region concerning this merger is, given the concentration of end customers, Randfontein. The SAFEX price at each silo in the region is thus the Randfontein price less the transport differential from the silo to Randfontein. As a general rule, the further the silo is from Randfontein, the lower the price.

[18] The SAFEX pricing mechanism creates an additional disincentive for farmers and traders to transport grain between the Afgri and MGK regions. Transporting grain towards Randfontein will incur transport costs but will be rewarded with increasing prices in compensation. Transporting grain past Randfontein for storage in the opposite region will incur transport costs which will not only not be compensated for in the SAFEX pricing model, but will also result in receiving lower prices as the grain is transported further from Randfontein.

[19] The legacy of regulation which resulted in silo operators owning silos in distinct regions, the location of the urban strip dividing the MGK and Afgri regions, the location of customers in Randfontein, the significance of transport costs relative to the value of product, and the SAFEX pricing mechanism all serve to disincentivise customers of grain storage facilities (farmers and traders alike) from transporting grain from the MGK region and storing it in the Afgri region, and vice versa. These strong incentives mean that MGK and Afgri do not compete with

one another for customers. This conclusion is supported by voluminous anecdotal evidence collected by the Commission.

[20] It follows that, because there is no competition between MGK and Afgri for silo storage facilities pre-merger, there is also no likely lessening or prevention of competition to result from this merger on a unilateral basis.

[21] The Commission, noting the previous collusion in the grain storage market, was also concerned that the merger might strengthen existing coordination or increase the likelihood of coordination.[13] On the first concern the Commission concluded that the previous collusion had come to an end and there was no evidence to suggest that firms were now coordinating in any form.[14]

[22] On the second concern the Commission concluded that the merger did not change the dynamics of competition in this market and hence would not increase any likelihood of achieving a coordinated outcome. The merger would, however, increase the symmetry between silo operators in general and between Afgri and Senwes in particular. Afgri's owns 65 silos pre-merger totalling 4.3 million tonnes of capacity. This is increased by the merger to 69 silos with 4.471 million tonnes of capacity, a change which makes Afgri's infrastructure more symmetrical to that of Senwes' 70 silos with 4.8 million tonnes of capacity.[15] The increased symmetry is argued not to be a cause for concern because competition occurs at the local level rather than in a wider geographic region, and symmetry is not increased at local levels.

[23] We agree with the Commission's conclusions that the merger is unlikely to strengthen or increase the probability of coordination between firms in the grain and oilseed storage market.

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[13] The previous collusion found in this industry was the fixing of SAFEX storage tariffs by GSI. The GSI was owned by the silo operators, and committees of the GSI were compiled using key employees from the silo operators.

[14] See section 10.7 on pages 71 to 77 of the Commission's report

[15] See section 10.7.3.2 on page 75 of the Commission's report

[24] Lastly, the Commission also investigated potential vertical concerns that might arise as a result of this merger. These arise because Afgri owns and operates mills which process maize and soya beans making Afgri a downstream customer of farmers and silos. For the reasons that follow, Afgri is not a potential customer for maize from MGK silos, nor do they source significant volumes of soya from MGK silos.

[25] Afgri's maize mills are located sufficiently far from the MGK region so as to make supply from the MGK region uneconomical. The maize supplied to these mills is instead sourced from local suppliers. The only, albeit limited, exception to this is Afgri's Isando mill which has sourced from the MGK region in isolated instances. The volumes for the 18 months prior to the Commission's investigation amounted in total to approximately 5% of the average output of the Isando mill for a month. The Commission concluded that these volumes are negligible and that the merger does not raise foreclosure concerns for maize.[16]

[26] Afgri's soya bean processing plant in Nedan sources from within the MGK region. This has the potential to raise concerns especially in the light of the fact that MGK takes ownership of a significant proportion of crops stored in their silos. This is a fundamental difference in the way the two firms operate; specifically, Afgri does not take ownership of the crops it stores.

[27] There were various reasons as to why the vertical relationship in soya bean supply and processing would not give rise to any potential competition concerns. The first is that the Nedan plant sources its soya predominantly through traders who, in turn, source from both within and outside the MGK region. The second reason is that the MGK region supplies a small proportion of the total downstream soya national output. [17] Finally, but perhaps most significantly, Afgri is not going to replicate MGK's operating model in the MGK region, but rather are going to continue with their policy to not own the grain and oilseed

[16] See section 11 on pages 77 and 78 of the Commission's report
[17] See section 11 on pages 78 and 79 of the Commission's report

stored in their silos.[18] This effectively removes the concern because Afgri will not be the owner of the soya being sold to their Nedan plant, instead the ownership will remain with farmers and traders. Furthermore, it is argued that this will effectively benefit farmers by increasing their customer base. The Commission concluded that the merger did not raise any foreclosure concerns in the soya bean market.

[28] We agree with the Commission's conclusions that the merger does not raise any foreclosure concerns in the supply and processing of either maize or soya beans.

[29] Finally, the merger did not raise any public interest concerns.

CONCLUSION

[30] For the reasons above, we approved the merger without condition.

Takalani Madima

27 November 2013
DATE

Medi Mokuena and Mondo Mazwai concurring.

Tribunal Researcher:	Andrew Sylvester
For the merging parties:	Desmond Rudman
For the Commission:	Werner Rysbergen

[18] See page 3 and page 7 of the transcript