



# Public Competition Assessment

3 May 2013

## Nestlé – proposed acquisition of Pfizer Nutrition

### Introduction

1. On 22 November 2012, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition by Nestlé S.A. (**Nestlé**) of Pfizer Nutrition, a global infant nutrition business, from Pfizer Inc. (**Pfizer**) (the **proposed acquisition**), subject to undertakings accepted by the ACCC on 22 November 2012 (the **undertakings**) pursuant to section 87B of the *Competition and Consumer Act 2010* (Cth) (the **Act**). The ACCC decided that the proposed acquisition, in conjunction with the undertakings, would be unlikely to have the effect of substantially lessening competition in the relevant markets in contravention of section 50 of the Act.
2. The ACCC made its decision on the basis of the information provided by the parties to the proposed acquisition (the **parties**) and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed acquisition, subject to confidentiality considerations.

### Public Competition Assessment

3. To provide an enhanced level of transparency in its decision making process, the ACCC issues a Public Competition Assessment for all proposals where:
  - an acquisition is opposed;
  - an acquisition is subject to enforceable undertakings;
  - the parties to the acquisition seek such disclosure; or
  - an acquisition is not opposed but raises important issues that the ACCC considers should be made public.
4. This Public Competition Assessment has been issued because Nestlé's proposed acquisition of Pfizer Nutrition is subject to court enforceable undertakings.
5. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to

circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change.

6. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on a case-by-case basis.
7. Public Competition Assessments outline the ACCC's principal reasons for forming views on a proposed acquisition at the time the decision was made. As such, Public Competition Assessments may not definitively identify and explain all issues that the ACCC considers arise from a proposed acquisition. Further, the ACCC's decisions generally involve consideration of both non-confidential and confidential information provided by the parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources.

## **The parties**

### **Nestlé**

8. Nestlé is a global food and beverage manufacturer listed on the Swiss stock exchange. Nestlé supplies a broad variety of food and beverage products, including dairy products, coffee beverages, cereals, condiments and confectionary products. Nestlé also supplies a range of health care and nutrition products.
9. Nestlé is active globally in the manufacture and wholesale supply of infant nutrition products. In Australia, Nestlé's infant formula and toddler milk brands include NAN and Lactogen.

### **Pfizer Nutrition**

10. Pfizer Nutrition is a leading global paediatric nutrition company listed on the New York, London, Euronext and Swiss stock exchanges. Pfizer Nutrition, formerly Wyeth Nutrition, is part of Pfizer, a multinational pharmaceutical corporation.
11. Pfizer Nutrition is active globally in the manufacture and supply of infant nutrition products. In Australia, Pfizer Nutrition's infant formula and toddler milk brands include S-26 and SMA.

## **Other industry participants**

### **Nutricia Australia**

12. Nutricia Australia (**Nutricia**) is a division of the French multinational company Danone. Globally, Danone supplies a range of fresh dairy products, bottled waters, baby nutrition and medical nutrition products.
13. In Australia, Nutricia supplies infant and toddler milk formula under the 'Karicare' and 'Karicare Aptamil' brands. Nutricia also supplies the 'Neocate' brand, a hypoallergenic range, which is only available through the pharmacy channel.

## **Heinz**

14. Heinz is a global food company. In Australia, it supplies infant formula and toddler milk under the 'Heinz Nurture' brand.

## **Bellamy's Organic**

15. Bellamy's Organic is a Tasmanian company that supplies certified organic infant formula and toddler milk under the brand 'Bellamy's Organic'.

## **Bayer**

16. Bayer is a global company that supplies health care and nutrition products. In Australia, Bayer supplies the 'Novalac' range of infant formula, which includes specialised infant formula designed to feed and manage common infant feeding problems of colic, constipation, diarrhoea and reflux. Bayer's products are only available through pharmacies.

## **Abbott**

17. Abbott Laboratories is a global health care company. In Australia, Abbott supplies specialised infant formula under the brands 'EleCare' and 'Isomil', which are only available through pharmacies.

## **Other**

18. Some pharmacies (for example Amcal) supply their own private label infant formula and toddler milk. ALDI has also entered with private label infant formula and toddler milk under its 'Mamia' brand.

## **The transaction**

19. Nestlé proposes to acquire the global infant nutrition business of Pfizer Nutrition. Globally, the proposed acquisition included Pfizer Nutrition's baby formula business, and prenatal and maternal vitamin products.

20. Nestlé's proposed acquisition is conditional on obtaining informal clearance from the ACCC.

## **Industry background**

21. Regulations in Australia applicable to nutritional milk formulas for infants and toddlers generally distinguish between two types of products:

- Starter Infant Formula and Follow-On Milk (**IFFO Milk**); and
- Growing-Up Milks (**GUMs**).

22. IFFO Milk has a special dietary use and is intended as a substitute for human breast milk. IFFO Milk is formulated for infants aged between 0 and 12 months and is typically available in two compositions:

- **Stage 1:** starter infant formula – for infants aged 0 to 6 months; and
- **Stage 2:** follow-on formula – for infants aged 6 to 12 months.

23. GUMs, also referred to as ‘toddler milks’, are formulated for children aged between 1 and 5 years (**Stage 3**).
24. There are also **specialty formulas** which are specifically formulated to address digestive problems or designed for infants and toddlers with special needs and are made available across all stages. Examples of specialty formulas include anti-reflux and lactose intolerance formulas. Certain specialty formulas are available over-the-counter at pharmacies while other specialty formulas require prescriptions.

## Regulatory requirements

25. Nutritional milk formulas for infants and toddlers, in particular IFFO Milk, are subject to a number of stringent regulatory requirements in Australia. These regulations relate to requirements for the ingredient composition of formulas and in respect of labelling and marketing of formulas.
26. The Marketing in Australia of Infant Formulas: Manufacturers and Importers Agreement (**MAIF Agreement**) prohibits manufacturers and importers of IFFO Milk from advertising or promoting IFFO Milk directly to the general public.<sup>1</sup> The MAIF Agreement does not apply to GUMs/toddler milks nor to retailers (such as supermarkets) or distributors of infant formula.
27. The MAIF Agreement also imposes limitations on the interaction between infant formula manufacturers and health care professionals to the provision of information relating to scientific and factual matters only.
28. Standard 2.9.1 of the Australia New Zealand Food Standards Code (**FSANZ Code**) provides for the compositional and labelling requirements for IFFO Milk. Standard 2.9.3 of the FSANZ Code sets out the compositional and labelling requirements for formulated meal replacements and formulated supplementary foods, which includes GUMs.

## Review timeline

29. The following table outlines the timeline of key events in this matter.

Date	Event
24 May 2012	ACCC commenced review under the Merger Review Process Guidelines.
14 June 2012	Closing date for submissions from interested parties.
5 July 2012	ACCC requested further information from the merger parties. ACCC timeline suspended. Former proposed decision date for announcement of ACCC's findings of 12 July 2012 delayed pending receipt of information requested.
13 August 2012	ACCC received further information from the merger parties following ACCC's request for information on 5 July 2012. ACCC timeline recommenced.
22 August 2012	ACCC timeline suspended at the request of Nestle to allow it to

<sup>1</sup> The MAIF Agreement was authorised by the then Trade Practices Commission (now the ACCC) in 1992. Authorisation of the MAIF Agreement was required as it contains marketing restrictions limiting competition and was granted on the basis that the public benefit outweighed any anti-competitive effect.

Date	Event
	provide further information. Former proposed decision date of 23 August 2012 delayed.
31 August 2012	ACCC published a Statement of Issues outlining preliminary competition concerns.
14 September 2012	Closing date for submissions relating to Statement of Issues.
11 October 2012	ACCC timeline suspended to allow Nestle and the ACCC to continue negotiations on a draft s87B undertaking. Former proposed decision date of 11 October 2012 delayed.
12 October 2012	Draft s87B undertakings proffered by Nestle. ACCC commenced market inquiries.
17 October 2012	Closing date for submissions on the draft s87B undertaking from interested parties.
24 October 2012	ACCC timeline suspended at the request of Nestle to allow it to provide further information. Former proposed decision date of 25 October 2012 delayed.
16 November 2012	ACCC timeline recommenced.
22 November 2012	87B undertaking accepted by ACCC.
22 November 2012	ACCC announced it would not oppose the proposed acquisition.

## Market inquiries

30. The ACCC conducted extensive market inquiries in relation to the proposed acquisition with a range of industry participants, including competitors, potential competitors, customers (the major supermarket chains, pharmacies and other retailers), hospitals, healthcare professionals, industry bodies and other interested parties.
31. Submissions were sought in relation to the substantive competition issues and proposed undertakings.

## Areas of overlap and market definition

32. The ACCC considered that the following two markets were most relevant to the assessment of the competitive impact of the proposed acquisition:
- the national market for the wholesale supply of IFFO Milk; and
  - the national market for the wholesale supply of GUMs.
33. The ACCC considered that regardless of the markets defined, market definition appeared unlikely to be a determinative feature of the competition assessment for the proposed acquisition. This was because both parties have a significant presence in the supply of both IFFO Milk and GUMs.
34. The ACCC notes that its approach to market definition is purposive, recognising that market definition is a tool to identify and define the boundaries of competitive overlap between the parties.

## **With/without test**

35. Section 50 of the Act prohibits mergers or acquisitions that would have the effect or be likely to have the effect of substantially lessening competition in any market. In assessing a proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment post-acquisition if the acquisition proceeds (the “with” position) to the likely future competitive environment if the acquisition does not proceed (the “without” position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.
36. In the absence of the proposed acquisition, the ACCC considered that the likely future competitive environment would be the status quo, that is, Pfizer Nutrition would continue to operate as an independent, viable and effective competitor in the supply of IFFO Milk and GUMs.

## **Statement of Issues**

37. The ACCC published its Statement of Issues (**Sol**) on 31 August 2012 identifying a number of competition issues and expressing its preliminary view that the proposed acquisition was likely to raise competition concerns in the relevant markets.
38. The ACCC was concerned that the proposed acquisition would result in highly concentrated markets with the top two players (a merged Nestlé/Pfizer Nutrition and Nutricia) controlling around 90% of the relevant markets.
39. In light of the strong brand equity of Nestlé and Pfizer Nutrition’s IFFO Milk and GUMs products as well as the substantial share of sales the merged firm would account for post-acquisition, the ACCC’s preliminary view was that the proposed acquisition was likely to result in muted competition and provide the merged firm with the ability to raise wholesale prices or reduce the level or frequency of the promotions/discounts that it offers to retailers.
40. In addition, a reduction in the number of major suppliers of IFFO Milk and GUMs from three to two increases the likelihood of coordinated conduct between the major suppliers of IFFO Milk and GUMs.

## **In-principle remedy proposal**

41. Prior to the release of the Sol, Nestlé provided the ACCC with an in-principle remedy proposal by which Nestlé would undertake to license to an approved purchaser, on an exclusive basis, Pfizer Nutrition’s entire Australian brand portfolio for a period of 5 years, with a subsequent 5 year period in which Nestlé would undertake not to reintroduce any of Pfizer Nutrition’s brands.
42. The Sol included details of the in-principle remedy proposal and the ACCC sought market feedback on the broad principles of Nestlé’s proposed remedy.

## **Competition analysis**

43. The ACCC’s market inquiries post-Sol did not raise any issues which would lead the ACCC to depart from its preliminary views expressed in the Sol.

44. The ACCC considered that, in the absence of the undertakings, the proposed acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in the relevant markets, as identified above.

### Removal of a close competitor

45. The ACCC considered that the proposed acquisition would result in a significant increase in concentration in already concentrated markets, where barriers to entry and expansion are high. The proposed acquisition would lead to the consolidation of two of the three major suppliers in both the IFFO Milk and GUMs markets. Post-acquisition the merged entity would account for approximately 60% of the share of sales in IFFO Milk and 50% in GUMs (Table 1) The proposed acquisition would result in only two major suppliers (a merged Nestlé/Pfizer Nutrition and Nutricia) controlling approximately 90% of sales in the relevant markets.

46. The ACCC considered that the proposed acquisition would lead to the removal of one of Nestlé’s closest competitors in the supply of IFFO Milk and GUMs and would reduce the number of major suppliers of IFFO Milk and GUMs with presence across the distribution channels (grocery/retail, pharmacy and hospital) from three to two. It would also lead to the consolidation of Pfizer Nutrition’s ‘S-26’ brand, which has long-standing trust and heritage in Australia, with Nestlé’s brand portfolio.

**Table 1 – Shares of supply – Starter Infant Formula and Follow-on Milk (IFFO Milk) and Growing-Up Milks (GUMs) (2011)**

Supplier	IFFO Milk	GUMs
Nestlé	21.5%	14.6%
Pfizer Nutrition	38.2%	34.8%
Merged entity	59.7%	49.4%
Nutricia	30.7%	37.2%
Heinz	4.5%	6.5%
Bellamy’s Organic	1.8%	6.8%
Bayer	2.2%	n.a.
Abbott	0.7%	n.a.
Other	0.4%	n.a.
TOTAL	100%	100%

Source: AC Nielsen Scan Data FY2011 by value (retail sales – grocery and pharmacy)

### High barriers to entry and expansion

47. The ACCC formed the view that barriers to entry and expansion are high for the supply of IFFO Milk and GUMs. Retail consumers exhibit a high degree of brand loyalty to their preferred brand which continues throughout the lifecycle of a consumer’s use of IFFO Milk and GUMs. The ACCC considered that the primary barrier to entry and expansion is the high degree of brand loyalty attached to the brands of the major incumbent suppliers.

48. Further, in light of the MAIF Agreement which prohibits manufacturers and importers of IFFO Milk from advertising or promoting IFFO Milk directly to the general public, the ACCC considered that the reputation and credibility of a brand of infant formula is established over many years through suppliers actively

engaging in building relationships with healthcare professionals and through a history of supply to, and association with, the hospital channel.

49. In addition, the major suppliers of IFFO Milk and GUMs each have multiple product offerings across a broad range of product segments and categories. As shelf space in the major supermarket and pharmacy chains is a finite resource, the brand proliferation undertaken by the incumbent suppliers may result in only limited opportunities being available for further new entry and expansion.
50. As a result of the high barriers to entry and expansion, the ACCC considered that the competition removed by the merger was unlikely to be replaced in the foreseeable future and as such the proposed acquisition would be likely to result in the entrenchment of a dominant player and/or duopoly in the supply of IFFO Milk and GUMs.

### **Countervailing Power**

51. Countervailing power exists when buyers have special characteristics that enable them to credibly threaten to bypass the merged firm, such as by vertically integrating into the upstream market, establishing import operations or sponsoring new entry.
52. The ACCC considered whether the major supermarket chains, as buyers of IFFO Milk and GUMs, would have sufficient countervailing power to constrain any attempt by a merged Nestlé/Pfizer Nutrition to increase wholesale prices and/or reduce the level or frequency of the promotions/discounts of IFFO Milk and GUMs products offered to retailers.
53. The ACCC formed the view that for the supply of IFFO Milk and GUMs products, the degree of countervailing power held by the major supermarket chains and the wholesale suppliers to pharmacies would be unlikely to effectively constrain a merged Nestlé/Pfizer Nutrition.
54. The ACCC understands that the brands supplied by Nestlé and Pfizer Nutrition are “must have” brands for the major supermarket chains and that retail consumers that purchase infant formula are typically high value grocery customers. Given the strong brand loyalty of the parties’ IFFO Milk and GUMs products and the importance of infant formula to retailers in enabling them to attract and retain high value retail consumers, the ACCC considered that the ability of the major supermarket chains to remove (or credibly threaten to remove) the products of the parties and replace them with a competitor’s products is limited. The ACCC considered that the negotiating position of a merged Nestlé/Pfizer Nutrition is likely to be even stronger post-merger in light of its significant share of sales in the supply of IFFO Milk and GUMs and the range of “must have” brands of infant formula it would command.
55. The ACCC also considered that private label entry by the major supermarket chains is unlikely to occur for IFFO Milk and GUMs. Due to the sensitivity of infants and the stringent regulatory requirements applicable to infant formula, the supply of private label IFFO Milk and GUMs involves considerable risks to a major retailer’s overall reputation, if any quality issues were to arise in the manufacturing or supply of the product. In any event, without the necessary investment in brand credibility and in establishing relationships with healthcare professionals, the ACCC considered that the major supermarket chains’ private label IFFO Milk and GUMs

products would be unlikely to pose a close or sufficient constraint on the IFFO Milk and GUMs products supplied by the merged entity.

## Undertakings

56. The ACCC conducted preliminary market inquiries on the in-principle remedy proposal referred to in paragraph 41 above. The preliminary feedback from market participants identified strong concerns and risks. The key concern identified was that the in-principle remedy proposal created significant risks that a purchaser may not be able to successfully transition Pfizer Nutrition's Australian brands to a purchaser's proprietary brand within Nestlé's proposed 5 year duration of the exclusive licence.
57. In response to the market concerns, Nestlé provided a revised remedy proposal to the ACCC. Nestlé subsequently formalised its remedy proposal in the form of a section 87B undertaking. To support the obligations in Nestlé's section 87B undertaking, Pfizer Australia Pty Ltd (**Pfizer Australia**) also offered a section 87B undertaking to the ACCC.
58. The core element of the revised undertakings requires Nestlé to license Pfizer Nutrition's Australian infant nutrition business' brand portfolio to an independent purchaser, on an exclusive basis. The undertakings are designed to provide the means for an ACCC approved purchaser to successfully transition and re-brand Pfizer Nutrition's S-26/SMA brand portfolio to its own proprietary brand over a number of years and also have the opportunity to build brand equity of the re-branded products in a 'black out' period during which Nestlé undertakes not to reintroduce any of Pfizer's brands.
59. On 22 November 2012, the ACCC accepted the revised court enforceable undertakings from Nestlé (the **Nestlé undertaking**) and Pfizer Australia (the **Pfizer undertaking**), pursuant to section 87B of the Act.
60. At the time of accepting the undertakings, the ACCC was aware of a number of potential purchasers of the divestiture business which have proven expertise in the manufacture and supply of IFFO Milk and GUMs.

## Nestlé Undertaking

61. The undertaking offered by Nestlé provides for Nestlé to license Pfizer Nutrition's Australian infant nutrition business's brand portfolio to a licensee to be approved by the ACCC and includes the following key elements:
  - an exclusive and fully paid-up licence to the brands used in relation to Pfizer Nutrition's infant nutrition products (SMA, S-26 and sub-brands) in Australia for a term of 10 years;
  - an exclusive and fully paid-up licence to the product formulations for the infant nutrition products currently sold by Pfizer Nutrition in Australia for a term of 10 years, and which is non-exclusive on a perpetual basis thereafter;
  - a non-exclusive perpetual licence to all process technology (including patents, manufacturing and marketing know-how) necessary to manufacture the licensed products, in existence as at the control date, as well as improvements to process technology developed by Nestlé for a period of no longer than 5 years;

- for a period of 10 years after the end of the 10 year exclusive licence, a commitment by Nestlé not to:
  - re-introduce into Australia any of Pfizer Nutrition's Australian infant nutrition brands; or
  - introduce into Australia the same formulations as used in the divestiture products, new products with non-material variations to these formulations or new products using the formulations to which a new ingredient has been added that would be a material variation to the formulations;
- not to disparage the approved purchaser or to market, promote or sell new infant nutrition products with reference to S-26/SMA, subject to certain conditions, for 5 years;
- a supply agreement for the licensed products prior to the approved purchaser self-manufacturing the relevant infant nutrition products for a period of up to 3 years;
- access to the results of clinical and product trials as conducted in respect of the licensed products or pipeline products for a period of up to 5 years; and
- access to detailed information in respect of key or unique product ingredients, including the sources of such product ingredients.

62. In addition, the Nestlé undertaking includes the transfer of Pfizer Nutrition's employees engaged in Australia who are wholly or primarily engaged in, or necessary for the operation of the divestiture business, all required consents and approvals and all business records. The undertaking also requires Nestlé to provide the approved purchaser with technical assistance for a limited duration of time.

63. The objective of the Nestlé undertaking is aimed at ensuring that the current level of competition in the relevant markets will be maintained through the creation of a strong third major supplier of IFFO Milk and GUMs in Australia. The Nestlé undertaking also seeks to ensure that the approved purchaser has the necessary assets, rights and agreements to allow it to operate the divestiture business as a viable going concern to compete effectively in the relevant markets.

## **Pfizer Undertaking**

64. Pfizer Australia also provided an undertaking to the ACCC pursuant to section 87B of the Act in relation to its obligations regarding the transfer of employees and the provision of transitional services to the approved purchaser. Pfizer Australia is required to provide a range of transitional services to maintain and protect the divestiture business during the hold separate period, including finance, personnel, commercial and marketing services, technology, real estate and facilities management services, procurement and supply chain and IT services.

65. The Pfizer undertaking is aimed at ensuring that the divestiture business would continue to be operated in substantially the same manner as prior to the transfer of the divestiture business.

66. The ACCC has also approved Pfizer Australia as the independent manager of the divestiture business, to manage the divestiture business from the date upon which the transaction between Nestlé and Pfizer Nutrition is completed until the date the

business is transferred to an approved purchaser, in accordance with the Nestlé undertaking.

## **Conclusion**

67. On the basis of the above, and taking into account the undertakings proposed by Nestlé and Pfizer, the ACCC formed the view that the proposed acquisition of Pfizer Nutrition by Nestlé would not have the effect or be likely to have the effect of substantially lessening competition in any market in contravention of section 50 of the Act.