Public Competition Assessment

19 October 2010

Swift Australia Pty Ltd - proposed acquisition of Rockdale Beef Pty Ltd

Introduction

1. On 9 September 2010, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition of Rockdale Beef Pty Ltd (**Rockdale**) by Swift Australia Pty Ltd (**Swift**) (**proposed acquisition**). The ACCC decided that the proposed acquisition would not be likely to substantially lessening competition in any market in contravention of section 50 of the *Trade Practices Act 1974* (the **Act**).

2. The ACCC made its decision on the basis of the information provided by the merger 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 and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:

   - a merger is opposed;
   - a merger is subject to enforceable undertakings;
   - the merger parties seek such disclosure; or
   - a merger is not opposed but raises important issues that the ACCC considers should be made public.

4. This Public Competition Assessment has been issued because Swift's proposed acquisition of Rockdale raises issues of interest for participants in the Australian beef industry and the public.

5. By issuing a Public Competition Assessment, 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 its own merits.

7. Public Competition Assessments are intended to outline to the general public the ACCC's principal reasons for reaching a decision on a proposed acquisition. As such they may not definitively explain all issues and the ACCC's analysis of such issues. Further, the ACCC's decisions generally involve consideration of both non-confidential and confidential information provided by the merger 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

Swift Australia Pty Ltd

8. Swift is a wholly owned subsidiary of JBS S.A., a large multinational meat processor based in Brazil and listed on the Sao Paulo stock exchange. In Australia, Swift operates a vertically integrated meat processing and beef feedlot business. Swift owns and operates five beef feedlots and eight beef processing abattoirs. Swift's feedlots are located in Caroona, Griffith and Burraboi in New South Wales, and in Toowoomba and Mungindi in Queensland. Swift has one beef processing abattoir at Brooklyn, Melbourne, four abattoirs in Queensland and three abattoirs in Tasmania.

Rockdale Beef Pty Ltd

9. Rockdale is jointly owned by Renod Holdings Pty Ltd (a subsidiary of Itoham Foods Inc) and MC Meats Rockdale Pty Ltd (a subsidiary of Mitsubishi Corporation). These companies are both based in Japan. Rockdale operates a single co-located beef feedlot and beef processing abattoir at Yanco in New South Wales.

Other industry participants

Feedlots

10. There are around 600 feedlots within Australia, the majority of which are located in areas that are in close proximity to cattle and grain supplies.[1] In addition to those operated by Swift and Rockdale, large feedlots on the eastern seaboard of Australia

[1] Australian Lot Feeders' Association, available at http://www.feedlots.com.au

include those operated by Teys Brothers, Cargill, Elders, Nippon and Mort & Co. A large number of small feedlots also operate along the eastern seaboard.

Abattoirs

11. There are a number of abattoirs that produce cold bone meat in southern New South Wales and Victoria. These include facilities operated by Cargill Beef, Norvic Food Processing, Ralphs Meat, Wagstaff and MC Herd.

Industry Background

12. In 2009, it was estimated that approximately 8.8 million cattle would be slaughtered in Australia in 2009-10, which would produce approximately 2,200 kilo-tonnes of beef.[2] Australia is a net exporter of beef, and currently exports over 65 per cent of its total beef production.[3] The level of exports varies depending on domestic production and overseas demand.

13. Cattle are bred and raised by farmers on pasture. After an initial period, younger and lighter cattle, referred to as feeder cattle, may be sold to feedlots for further fattening on grain (**grain fed cattle**) or retained by the farmer for fattening on pasture (**grass fed cattle**) prior to being transferred to an abattoir for slaughter. Farmers may also sell feeder cattle to backgrounders or restockers.

14. Backgrounders and restockers are cattle producers (farmers) who purchase feeder cattle to be fed on pasture. Backgrounders purchase young cattle (sometimes before they reach feeder weight) to feed on grass. They may then elect to sell them to feedlot operators for further fattening on grain before slaughter, or sell directly to abattoirs. Restockers purchase feeder cattle to increase the size of their herd after times of significant turnoff such as drought.

15. Lot feeding is an intensive production system designed to fatten cattle on grain-based feed prior to slaughter. A feedlot is a confined yard area with watering and feeding facilities where cattle are completely hand or mechanically fed.[4]

16. Once cattle (either grass fed or grain fed) meet the desired weight specifications and other characteristics for slaughter they are known as fat cattle. Fat cattle may be purchased by abattoirs for processing or processed by abattoirs on behalf of third parties (who retain ownership of the cattle) under a service kill arrangement.

17. Abattoirs may undertake a number of stages in beef processing including slaughter, hide removal, boning, packaging and freezing or chilling of meat for supply to domestic or export customers.

18. Fat cattle are directed to either the export or domestic market, depending on the weight and quality of the beast. Beasts slaughtered for the purposes of producing

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[2] IbisWorld, *Beef Cattle Farming in Australia*, December 2009, p4
[3] Australian Agriculture, Fisheries and Forestry, <http://www.dfat.gov.au/facts/affaoverview.html>, accessed 31 August 2010.
[4] CSIRO, *National Guidelines for Beef Cattle Feedlots in Australia (second edition)*, p10

export grade beef tend to be significantly larger than those slaughtered for domestic grade beef.[5]

19. Post slaughter, the beef carcass is processed using either the cold bone or hot bone procedure. The production of cold bone beef requires that the carcass be chilled which allows the meat to "set" before the carcass is further processed into certain cuts. The cold bone process allows for high quality cuts of beef. Good quality fat cattle are generally processed into cold bone beef.

20. Hot bone beef production involves removing the bones from the beef carcass shortly after slaughter, without first refrigerating the carcass. Hot bone beef is often used to produce mince meat or in the manufacture of processed food. The cattle that are slaughtered in hot bone abattoirs are typically of a poorer quality (e.g. dairy cows) than those that are slaughtered in a cold bone abattoir. The main difference between hot bone and cold bone abattoirs is the additional refrigeration that is needed for cold bone meat production.

21. Of the beef abattoirs that operate in Australia, most produce cold bone beef while a smaller number produce hot bone beef. Some abattoirs produce both cold bone and hot bone beef products.

The proposed transaction

22. Swift proposes to acquire Rockdale, which includes all of the assets necessary to continue the operation of the abattoir and feedlot presently operated by Rockdale.

Timing

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

Date	Event
8 April 2010	ACCC commenced review under the Merger Review Process Guidelines.
30 April 2010	Closing date for submissions from interested parties.
26 May 2010	ACCC requested further information from Swift Australia. ACCC timeline suspended to allow Swift Australia to respond to the ACCC's request for further information.
4 June 2010	ACCC received further information from Swift Australia. ACCC timeline remained suspended to await further information from Rockdale Beef.
10 June 2010	ACCC received further information from Rockdale Beef. ACCC timeline recommenced.
24 June 2010	ACCC published a Statement of Issues outlining preliminary competition concerns.

[5] Export grade beef may be acquired by beef wholesalers and retailers in the domestic market, and will not necessarily be exported.

6 July 2010	Closing date for submissions relating to Statement of Issues.
13 July 2010	ACCC requested further information from Swift Australia.
14 July 2010	ACCC requested further information from Rockdale Beef. ACCC timeline suspended to allow the merger parties to provide the information requested.
26 July 2010	ACCC received further information from Rockdale Beef and a partial response from Swift Australia to the ACCC's information request. ACCC timeline recommenced.
12 August 2010	ACCC received further information from Swift Australia. Former proposed decision date of 26 August 2010 amended to allow the ACCC to consider additional information provided by Swift Australia.
9 September 2010	ACCC announced it would not oppose the proposed acquisition.

Market inquiries

24. The ACCC conducted market inquiries with a range of industry participants, including small and large feedlot operators, abattoirs, customers, industry bodies and other interested parties. Submissions were invited from interested parties.

Statement of Issues

25. On 24 June 2010, the ACCC published a Statement of Issues regarding the proposed acquisition. In the Statement of Issues the ACCC stated its preliminary view that the proposed acquisition may raise competition concerns by reducing competition for the acquisition of feeder and/or fat cattle in southern/central NSW and Victoria. In particular, the ACCC identified a concern that, post acquisition, Swift may be in a position to lower or otherwise distort the prices paid for feeder and/or fat cattle as a result of a decrease in competition. The ACCC did not consider that the proposed acquisition was likely to raise competition concerns in relation to the supply of processed beef.

26. The Statement of Issues is available on the ACCC's website at www.accc.gov.au/statementsofissues.

Areas of overlap and market definition

27. The operations of Rockdale and Swift overlap in the acquisition of feeder cattle and fat cattle, particularly in the Victoria and southern/central NSW region where both have feedlots and cold bone abattoirs, and in the supply of processed beef.

28. The ACCC considered the proposed acquisition in the context of the following markets:

    - the market for the acquisition of feeder cattle in southern/central NSW and Victoria (**acquisition of feeder cattle market**);
    - the market for the acquisition of fat cattle by cold bone abattoirs in southern/central NSW and Victoria (**acquisition of fat cattle market**);

- the market for the supply of processed beef on Australia's eastern seaboard (**supply of processed beef market**).

Product dimension – cattle acquisition markets

Feeder and fat cattle

29. The ACCC noted that acquirers of feeder cattle and acquirers of fat cattle were separate and distinct categories of buyers that perform different functions and require cattle with different characteristics. Acquirers of fat cattle purchase older, heavier cattle that are ready for slaughter, whereas acquirers of feeder cattle purchase younger, lighter cattle that require further feeding prior to slaughter. While abattoirs may have an ability to slaughter feeder cattle, this is generally not economically viable given that feeder cattle are lighter beasts. At the margins, some heavier feeder cattle could be considered suitable for processing for domestic use, however market inquiries found that such opportunities were limited.

30. Market inquiries indicated that on the supply-side, producers could not switch easily between supplying feeder cattle and fat cattle. While physically it is possible to switch between selling cattle as feeder cattle and fat cattle (e.g. by retaining feeder cattle on grass until they reach fat cattle weight), it was found that in most cases, switching would not be realistic in the short term, and is more likely to be undertaken as part of a longer term strategy for feeder cattle producers in relation to their future cattle herds, and not their current herds.

31. Pricing practices in the beef industry also show a clear distinction between feeder and fat cattle. Publications such as "The Land" newspaper separately list the prices realised for feeder cattle according to certain specifications on a weekly basis. Furthermore, the industry regularly holds fat cattle sales (as distinct from feeder sales which are held separately).

32. In light of the above, the ACCC considered that there are separate markets for the acquisition of feeder cattle and fat cattle. While making this distinction, the ACCC noted that these product markets are related, as feeder cattle are essentially an input into the production of fat cattle.

Acquisition of fat cattle

Acquisition by processors of other meats

33. The ACCC further considered whether the relevant acquisition market for fat cattle should be defined to include the acquisition of fat cattle by processors of small animals including lambs, pigs and goats.

34. Market inquiries revealed that abattoirs designed to slaughter small animals such as lambs, pigs and goats are not suitably structured to handle cattle and would require considerable investment to do so. Similarly, abattoirs designed to slaughter cattle are not designed to handle small animals. Accordingly, the ACCC took the view that acquirers of small animals for meat processing were not close substitutes for cattle processors, and consequently, the product dimension of the relevant

acquisition market should be confined to fat cattle, and abattoirs that slaughter these types of animals.

Acquisition by hot bone processors

35. The ACCC considered whether the relevant acquisition market should be defined to include the acquisition of fat cattle by hot bone processors as well as cold bone processors.

36. The ACCC's preliminary view in its Statement of Issues was that hot bone and cold bone facilities were likely to compete for fat cattle. However, further market inquiries indicated that hot bone abattoirs were not close substitutes to cold bone abattoirs for the acquisition of fat cattle.

37. Hot bone abattoirs generally acquire older or lower quality cattle (such as dairy cattle that no longer produce milk) for the production of ground beef. Prime quality cattle (such as fat cattle) are significantly more expensive than the older or lower quality cattle. Inquiries indicated that hot bone abattoirs are significantly constrained in the price they can pay for cattle due to the price they can obtain for their output product. The ACCC considered that the price of fat cattle would have to decrease by a very large amount before producers of fat cattle would switch a significant proportion of sales of fat cattle from cold bone abattoirs to hot bone abattoirs.

38. It was also noted that hot bone processors could not easily switch production capacity to cold bone production, as the two processes are different and involve different plant and equipment. In particular, while hot bone facilities have suitable equipment to slaughter cattle, they generally lack the refrigeration equipment required for cold bone beef production.

39. Accordingly, the ACCC considered that the product dimension of the relevant acquisition market should be limited to the acquisition of fat cattle by cold bone abattoirs.

Acquisition by export-accredited and domestic abattoir facilities

40. The ACCC considered whether the acquisition of fat cattle for export-accredited and domestic abattoir facilities should be treated as falling within the same market, or separate markets.

41. Market participants indicated that there are various types of fat cattle acquired for slaughter. For the most part, larger, heavier fat cattle are slaughtered for the production of export grade beef, while smaller fat cattle are slaughtered to produce domestic grade beef.

42. Not all abattoir facilities are capable of processing all cattle types. Abattoirs that export beef are required to pass an accreditation process and are often configured to handle both larger and smaller cattle. The ACCC considered that these facilities can substitute between acquiring lighter and heavier fat cattle in response to a small but significant decrease in the price of either of these types of cattle.

43. Abattoirs that are set up to slaughter only lighter fat cattle may not have the necessary facilities and equipment to slaughter heavier fat cattle and would have to make additional investments in modifying or reconfiguring their facilities before they could effectively slaughter larger beasts. However, these facilities may represent a substitute buyer for heavier fat cattle producers, who may be able to sell fat cattle earlier at a lighter weight to domestic abattoir facilities in response to a small but significant decrease in the price of heavier fat cattle.

44. On this basis, the ACCC considered that the acquisition of fat cattle by export-accredited facilities and the acquisition of fat cattle by domestic facilities should be considered as part of the same market. Nevertheless, it was noted that domestic facilities set up to slaughter lighter fat cattle are not as close a substitute for export-accredited facilities for acquiring heavier cattle as they are for lighter beasts.

Conclusion – product dimension – acquisition markets

45. The ACCC considered that there are separate markets for the acquisition of feeder cattle, and the acquisition of fat cattle by cold bone abattoirs.

Geographic dimension – feeder cattle

46. Market inquiries indicated that cattle producers bear the cost of transporting cattle to customers (feedlots etc) and prefer to transport feeder cattle the shortest possible distance to minimise transport costs and potential damage to livestock. Transport costs include not only the direct cost of transporting cattle, but also the cost of having the cattle lose weight and condition during transit (referred to in the industry as 'shrinkage[6]').

47. Market participants indicated that there is frequent movement of feeder cattle within the Victoria and southern/central NSW region but very limited movement of cattle between northern NSW/southern Queensland and southern/central NSW and Victoria. The transportation of cattle over long distances appears to occur only as a response to unusual market or seasonal conditions.[7] The ACCC considered that a small but significant decrease in the price of feeder cattle within southern/central NSW and Victoria would be unlikely to lead to feeder cattle producers selling cattle to buyers outside of the region in significant quantities.

48. On this basis, the ACCC considered that the relevant market for the acquisition of feeder cattle extends from central NSW into Victoria.

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[6] Shrinkage is a combination of (i) loss of condition suffered during transport, and (ii) loss of weight due to the animal being off food during transport.

[7] While demand for feeder cattle remains reasonably constant year round, supply can fluctuate due to seasonal weather conditions. At certain times of the year, feeder cattle will be more abundant in central/southern NSW and Victoria than in northern NSW and southern Queensland (and vice versa). During these times, acquirers of feeder cattle in areas of low supply may acquire feeder cattle from further away than usual, leading to a seasonal variation in the distance that feeder cattle are transported. Market inquiries indicated that transport over long distances due to seasonal variations accounts for a small percentage of the sales of feeder cattle from southern/central NSW and Victoria.

Geographic dimension – fat cattle

49. As was the case in the market for the acquisition of feeder cattle, the ACCC found that the cost of transporting fat cattle was the key factor in defining the geographic scope of this market. Transport cost relates not just to the cost of haulage, but also to potential damage to the beasts during transport, shrinkage and stress, which can all affect the quality of the final beef product, and hence the value of the fat cattle being slaughtered. Market inquiries indicated that the further the fat cattle are transported, the greater the loss of condition and the more likely it is that the beasts will be damaged, decreasing the value of the cattle that are sold.

50. The ACCC considered that the geographic scope of the relevant market for the acquisition of fat cattle includes southern/central NSW and Victoria. Market inquiries revealed that fat cattle producers within this region saw cold bone abattoirs within the region as potential alternative acquirers of their fat cattle. Facilities further north were less likely to be considered an attractive alternative for fat cattle producers within southern/central NSW and Victoria (due to the distance involved in accessing the facility) and accordingly, were not considered to be sufficiently close substitutes to be included in the relevant market.

51. The ACCC noted that abattoirs in northern New South Wales and southern Queensland may be considered as a possible substitute to Rockdale's Yanco facility for some fat cattle producers located at the northern edge of the southern/central NSW region. However, the ACCC took the view that abattoirs in northern NSW and southern Queensland were not a viable alternative for the majority of producers located in Victoria and southern/central NSW, and accordingly were considered to compete only on the margins of the market.

Supply of processed beef

52. The ACCC's preliminary view in its Statement of Issues was that the relevant market for processed beef was likely to be a national or east coast market for the wholesale supply of beef. The ACCC considered that on the demand-side beef and other non-beef meat products were not close substitutes for meat wholesalers and retailers. In addition, the ACCC considered that on the supply-side other non-beef meat producers could not easily switch to the production of beef in response to a small but significant increase in the price of processed beef. Accordingly, the ACCC concluded that there is a separate market for the supply of processed beef.

53. The ACCC consulted a number of market participants following the Statement of Issues, who confirmed that the competition between suppliers of processed beef in Western Australia and the eastern seaboard of Australia was often limited. Consequently, the ACCC considered that the market should be confined to the eastern seaboard of Australia.

With/without test

54. In assessing a merger or acquisition pursuant to section 50 of the Act, the ACCC must consider the effects of the transaction by comparing the likely competitive environment if the transaction proceeds (the "with" position) to the likely

competitive environment if the transaction does not proceed (the "without" or "counterfactual" position).

55. The ACCC noted that at the time of this merger review, Rockdale's feedlot facility was under-utilised and Rockdale was no longer competing strongly for the acquisition of feeder cattle for its feedlot facilities. However, in assessing the likely counterfactual, the ACCC considered whether Rockdale's facility was likely to be more fully utilised in the future if the transaction did not take place, or whether the facility would continue to be underutilised or exit the market.

56. The ACCC received information that a number of buyers were interested in acquiring Rockdale's assets in the event that the proposed acquisition did not go ahead. The ACCC also considered that Rockdale's facilities were attractive to alternative bidders. Market participants generally indicated that Rockdale's co-located beef feedlot and abattoir is highly regarded in the industry and is a high quality, modern facility that is close to grain and cattle supplies.

57. The ACCC considered that, in the absence of the proposed acquisition, Rockdale's facilities were likely to be acquired by an alternative bidder and operated independent of Swift. The ACCC also considered that the future operator of Rockdale's assets was likely to more fully utilise the feedlot and abattoir facilities and, consequently, be more active in the acquisition of fat and feeder cattle than Rockdale is currently.

Competition analysis

Acquisition of feeder cattle – unilateral effects

58. The ACCC examined whether the proposed acquisition was likely to result in a substantial lessening of competition in relation to the acquisition of feeder cattle by way of unilateral effects.[8] In particular, the ACCC examined whether, as a result of the proposed acquisition, the merged entity would be likely to be able to significantly and sustainably reduce the price of feeder cattle. In this regard, a key issue investigated was whether sufficient competitive forces would remain to constrain the merged entity post-acquisition.

Competition from other feedlots

59. The ACCC considered the extent to which competition from rival feedlots was likely to prevent the merged entity from reducing the price that it pays for feeder cattle.

60. Rockdale owns and operates one feedlot in the relevant market, in Yanco, NSW, while Swift owns and operates feedlots in Tabbita and Burraboi, NSW, which are

[8] Mergers have unilateral effects when they remove or weaken competitive constraints in such a way that the merged entity's unilateral market power is increased. That is, as a result of the merger the merged entity finds it profitable to raise prices (or in the case of the market for the acquisition of feeder cattle, reduce the price it pays), reduce output or otherwise exercise market power it has gained, and can do so without any change in the nature of other market participants conduct.

approximately 100 kilometres and 300 kilometres respectively from Rockdale's feedlot.

61. By acquiring Rockdale, Swift will become the largest feedlot operator in the market. However, five other large feedlot providers will remain in the market post-merger. These are Peechelba (ICM) Feedlot at Wangaratta, Elders Charlton Feedlot at Yeungroon, Cargill at Springdale, Ravensworth Feedlot at Hay, and Hell's Gate at Balranald. The ACCC considered that these larger feedlots have similar attributes to Swift and Rockdale's feedlots and will continue to compete against the merged entity for the acquisition of feeder cattle.

62. In addition, there are a number of medium to small feedlots in the market, including Garrison Feedlot, Jabell Feedlot, Bunaloo Pastoral, Gundamain and Associated Feedlot as well as approximately 50 other feedlots in the market with a capacity of less than 5000 head.

63. The ACCC considered that competition from a combination of rival feedlots with large facilities and medium to small feedlots was likely to provide an effective competitive constraint on the merged entity post-merger. In particular, the ACCC considered that the presence of a number of competitors with significant spare capacity was likely to prevent the merged entity from significantly decreasing the price it pays for feeder cattle.

64. Market participants indicated that there has been significant spare capacity in feedlot operations in NSW and Victoria for an extended period of time, and this is likely to continue in the foreseeable future. Further, market inquiries revealed that there are typically no long term contracts in relation to the supply of feeder cattle to feedlots, and a feedlot with spare capacity could readily acquire feeder cattle if there was a business rationale to do so, such as where the merged entity attempted to decrease the price of feeder cattle.

65. Market inquiries revealed that while small and medium sized feedlots did not individually provide as strong a competitive constraint on the merger parties as larger feedlots, smaller feedlots have been successful in gaining the business of large customers in downstream markets, including major supermarkets.[9] Accordingly, the ACCC considered it likely that small and medium sized feedlots would also continue to impose a competitive constraint on the merged entity in relation to the acquisition of feeder cattle post-merger.

Other factors

66. In addition to the constraint from permanently operating feedlots, market inquiries indicated that a number of smaller feedlots in the market operate on an opportunistic basis. These feedlots can operate with few or no cattle in their feedlot when conditions are unfavourable (e.g. feeder cattle prices are high or feed is expensive) and re-enter by acquiring feeder cattle when conditions are more

[9] The supermarket chains are active acquirers of feeder cattle. These businesses do not generally own feedlot or farm assets capable of fattening cattle, but instead contract with feedlots and farmers to feed cattle on their behalf. The ACCC is aware that the supermarket chains utilise a number of smaller feedlots for this purpose.

favourable. This includes times when the prices of inputs (feeder cattle and grain) are lower and/or when the price of fat cattle is higher. These opportunistic feedlots are responsive to changes in the price of feeder cattle, and are likely to compete more strongly for feeder cattle if the price falls. The ACCC considered that opportunistic entry and exit by these businesses may provide some further degree of competitive constraint on the merged entity in the event that it attempted to decrease the price of feeder cattle.

67. The ACCC considered that timely new entry for medium to large feedlots was unlikely. In particular, the ACCC considered that existing excess feedlot capacity within the market; the need to obtain appropriate planning and environmental permits; the presence of sunk costs; and the need to situate a feedlot on land close to grain, water and cattle supply were likely to deter a new large or medium scale entrant from supplying lot feeding services. Accordingly, the ACCC did not consider that the threat of new entry from large to medium sized feedlots was likely to be a strong constraint on the merged entity in the event that it attempted to decrease the price of feeder cattle.

68. The ACCC found that backgrounders and restockers would provide an additional competitive constraint on the merged entity, but the level of competition provided by these industry participants is likely to vary, depending on a number of factors, particularly climatic conditions. Market inquiries indicated that backgrounders and restockers are very active buyers of feeder cattle at certain times. During these times, backgrounders and restockers are likely to compete vigorously with the merged entity and other feedlots to acquire feeder cattle. However, the purchasing patterns of backgrounders and restockers are largely determined by the amount of grass available to them on farm and, as such, weather patterns such as drought can significantly affect the number of cattle purchased.

Acquisition of feeder cattle – coordinated effects

69. The ACCC also considered whether the proposed acquisition was likely to result in a substantial lessening of competition in the feeder cattle acquisition market through coordinated effects.[10]

70. The ACCC found that there are features of the feeder cattle markets that may tend to make coordination more feasible than in some other markets. Major feedlots issue pricing grids stating their offer price for feeder cattle[11] and whether they are buying cattle in the particular period. Trading of feeder cattle takes place frequently and feeder cattle within a given specification are reasonably homogeneous goods.[12]

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[10] Mergers have coordinated effects when they assist firms in the market in implicitly or explicitly coordinating their pricing, output or related commercial decisions. A merger may do so simply by reducing the number of firms among which to coordinate, by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely.

[11] Pricing grids for feeder cattle are sometimes referred to as specification lists.

[12] Feedlots acquire different weight feeder cattle depending on whether the animals are destined for use in domestic or export grade beef. Cattle are fairly homogeneous within these weight ranges, as they must meet certain defined specifications prior to sale.

71. The ACCC considered that sufficient constraints would exist in the relevant market post acquisition to prevent a substantial lessening of competition from occurring by way of coordinated effects. In particular, the ACCC considered that the large number of medium to large sized feedlots would increase the difficulty involved for the remaining firms to effectively engage in coordinated conduct. The number of effective competitors in the market would increase the chance of firms deviating from any attempted coordination and increase the difficulty involved for firms wishing to monitor the pricing behaviour of their competitors.[13]

72. To a lesser extent, the ACCC considered that other factors such as potential seasonal acquisitions of feeder cattle by feedlots outside of the market and opportunist activities by backgrounders, restockers and smaller feedlots may also disrupt any attempt to engage in coordinated conduct.

Summary – acquisition of feeder cattle

73. The ACCC considered that the proposed acquisition would not result in a substantial lessening of competition in the market for the acquisition of feeder cattle. In reaching this conclusion, the ACCC considered that large rival feedlots together with a significant number of smaller feedlots would continue to compete with and constrain the pricing decisions of the merged entity. The ACCC also considered that the large number of competing feedlots would likely prevent a substantial lessening of competition from occurring by way of coordinated effects.

74. In addition, the ACCC considered that backgrounders, restockers and abattoirs are likely to provide some competitive constraint on the merged firm, as they are active to varying degrees in the acquisition of feeder cattle.

Acquisition of fat cattle – unilateral effects

75. The ACCC considered whether the proposed acquisition was likely to lead to a substantial lessening of competition in the market for the acquisition of fat cattle by way of unilateral effects. In particular, the ACCC examined whether the merged entity would be able to significantly and sustainably decrease the price it paid to acquire fat cattle or otherwise exercise market power following the acquisition.

Competition from other abattoirs

76. Post acquisition, the merged entity will own two large export accredited cold bone abattoirs in the relevant market, giving it the highest fat cattle slaughter capacity in that region. It was found that the merger parties were active in the acquisition of fat cattle for both export (heavier beasts) and domestic uses (lighter beasts).

77. However, market enquiries indicated that the combination of other large export accredited cold bone abattoirs and non-export accredited domestic facilities within

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[13] Firms in a market will have an incentive to deviate from a coordinated consensus unless they fear punishment that would outweigh the potential short-term gains from cheating on the terms of coordination. Punishment may simply involve a return to competitive conditions or, for example, a 'price war'. The incentive to cheat is increased if the imposition of punishment is likely to be significantly delayed (for example, because market transactions are infrequent). The credible threat of effective punishment alone may be sufficient to deter cheating.

Victoria and southern/central NSW would continue to provide an effective competitive constraint on the merged entity post-acquisition.

Other large export accredited cold bone processors

78. The ACCC identified a number of other large export accredited facilities in the relevant market, including facilities operated by Cargill, Norvic Food Processing, MC Herd, G&K O'Connor, GBP Exports and Tabro Meats. The ACCC also identified a number of other smaller export accredited facilities within the relevant market.

79. Market inquiries indicated that these facilities were close competitors to the merger parties, and would continue to provide an effective competitive constraint post-acquisition, as they are active in buying all types of fat cattle for slaughter, including both export and domestic grade beef. Accordingly, the ACCC considered that the threat of fat cattle producers selling to a competing export accredited abattoir facility is likely to act as a significant constraint on the pricing decisions of the merged entity.

80. Market inquiries indicated that some other export accredited abattoirs located just outside of the relevant market, such as Teys and T&R Pastoral in SA, compete to acquire fat cattle from at least some of the fat cattle producers within the relevant market. However, given the transport distances involved to these facilities, for most producers of fat cattle in the relevant market, these facilities represent a less attractive alternative to facilities operating in southern/central NSW and Victoria. The ACCC considered that these facilities represent a weaker, although still relevant, constraint on the pricing decisions of the merged entity.

Non-export accredited cold bone processors

81. The ACCC identified five non-export accredited facilities within the relevant market. Market inquiries indicated that these facilities largely acquire lighter grass fed fat cattle, and lighter grain fed fat cattle when the supply of grass fed fat cattle is low (which is largely determined by seasonal weather patterns). The ACCC considered that post-merger, these facilities would continue to compete with the merged entity, particularly for lighter fat cattle.

82. It was found that these facilities would not provide the same level of competitive constraint on the merger parties as the export accredited facilities, particularly in relation to the acquisition of heavier cattle. Export accredited abattoirs are generally equipped to process heavier (export grade) fat cattle and can also process lighter (domestic grade) fat cattle. Non-export accredited facilities mostly lack the plant and equipment necessary for slaughtering larger animals. Market inquiries also indicated that while there are some additional costs (such as quarantine certification) for export accredited facilities, they are generally able to extract greater revenue from a given carcass by selling the off-cuts, such as offal, into

export markets[14] and are therefore generally preferred by sellers of grain fed fat cattle.

83. It was also found that while the threat of fat cattle producers selling potentially heavier cattle early at a lighter weight to these abattoirs may also pose some constraint on the merged entity, this would provide only a limited constraint.

Other factors

84. Market inquiries indicated that barriers to entry in the relevant market are high. Market inquiries indicated that there are significant sunk costs involved in establishing new abattoir facilities (particularly large export accredited facilities), while compliance with planning and environmental legislation can be expensive and take long periods of time to complete.

85. While barriers to entry are likely to be high, the ACCC considered that larger participants in the beef industry may be willing to construct new facilities where there is a sufficient incentive to do so. For example, AACo has announced plans to construct an abattoir in the Northern Territory in response to an increase in supply of fat cattle in that region.[15] [16] Also, some of the abattoirs that engage solely in hot bone beef production would face less significant barriers to entry if they wished to commence cold bone production than would a new entrant (depending on the location and age of the facility). In many cases, these facilities have many of the relevant permits, relationships with customers and suppliers, some plant and equipment and skilled staff that are suitable to beef production. Because of this, hot bone abattoirs face fewer barriers to entering cold bone beef production than a completely new entrant would face.

86. However, while considering that new entry may be possible in the longer term, the ACCC did not consider that the threat of new entry was likely to be a strong constraint on the merged entity in the event that it attempted to decrease the price of fat cattle. The ACCC therefore relied on other competitive constraints in forming its view that the proposed acquisition was not likely to substantially lessen competition.

Acquisition of fat cattle – coordinated effects

87. The ACCC considered whether the proposed acquisition was likely to result in a substantial lessening of competition in this market due to coordinated effects.

88. As was the case with feeder cattle, the ACCC found that there are features of the fat cattle market that may tend to make coordination more feasible than in some

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[14] The domestic market for these off-cuts is small, and demand is higher in export markets. Only export accredited abattoir facilities are able to access the export markets.

[15] Restrictions on the export of live fat cattle to Indonesia have led to an increase in the domestic supply of fat cattle in the Northern Territory. Many cattle from this region were previously exported live to Indonesia. However, it is noted that market conditions in the Northern Territory are different to those in the relevant market, and it is therefore not safe to infer from this proposed new entry in the Northern Territory that similar new entry is likely in the relevant market.

[16] http://theland.farmonline.com.au/news/state/livestock/cattle/restrictions-prompt-aaco-abattoir-plan/1914135.aspx

other markets, such as the issuing of price grids by abattoirs[17], transactions taking place on a frequent basis and fat cattle of a given specification being a reasonably homogeneous good.

89. However, the ACCC ultimately considered that there would be sufficient constraints in the relevant market post acquisition to prevent a substantial lessening of competition from occurring by way of coordinated effects.

90. In particular, the ACCC considered that the number of abattoirs competing effectively in the relevant market post acquisition would make it difficult to organise and maintain coordinated conduct (either explicitly or implicitly) between the remaining firms. The ability of firms to monitor the prices paid by their competitors, which is normally an important element in maintaining coordinated conduct, is likely to be made more difficult due to the number of competing abattoirs. This large number of effective competitors makes deviation from a coordinated price more likely, and punishment of such deviation more difficult.

91. To a lesser extent, the ACCC considered that other factors such as potential seasonal acquisitions of fat cattle by abattoirs outside the market and the threat of new entry may also disrupt efforts by the remaining firms to engage in coordinated conduct.

Summary – acquisition of fat cattle

92. The ACCC considered that, post acquisition, producers of fat cattle would continue to have a number of alternative buyers (abattoirs) for their fat cattle. The ACCC considered that the threat of fat cattle producers diverting supply to competing abattoirs in response to a decrease in price by the merged entity was likely to act as the key competitive constraint on the merged entity's pricing decisions. The ACCC also considered that the presence of alternative acquirers of fat cattle was likely to prevent a substantial lessening of competition from occurring from coordinated effects.

93. Consequently, the ACCC did not consider that a substantial lessening of competition was likely in relation to the acquisition of fat cattle market as a result of unilateral or coordinated effects.

Acquisition of fat and feeder cattle – vertical foreclosure

94. The ACCC also examined whether the proposed acquisition would be likely to lead to vertical foreclosure[18] by the merged entity, given that the merged entity will be both a seller of fat cattle from its feedlots and an acquirer of fat cattle for its

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[17] As with price grids for feeder cattle, the ACCC found that price grids for fat cattle represented a good guide to pricing, but did not reflect actual final prices.

[18] A vertically integrated merged entity would be able to engage in foreclosure strategies against rival downstream firms if it had sufficient market power in the upstream market—that is, where its downstream rivals faced insufficient viable supply alternatives. This might occur for a variety of reasons including capacity constraints faced by rival upstream suppliers, barriers to entry or product differentiation between the products and/or services offered by the integrated firm and its rivals. Similarly, an integrated merged firm would only be able to engage in foreclosure strategies against rival upstream firms if it had sufficient market power in the downstream market.

abattoirs. In particular, the ACCC examined whether the merged entity would be able to use its position as an acquirer of fat cattle to profitably disadvantage or stop competing feedlot operators from selling fat cattle in an attempt to remove competing feedlots from the market and similarly, whether the merged entity could use its feedlots to drive competing abattoirs out of the market by distorting fat cattle prices or disrupting access to fat cattle. Ultimately, and consistent with the ACCC's consideration of unilateral effects, the ACCC did not consider that the merged entity was likely to gain sufficient market power in either of these relevant markets to successfully lessen competition by way of vertical foreclosure.

Supply of processed beef

95. The Statement of Issues noted in relation to this matter a preliminary view that competition issues were unlikely to arise in relation to the market for processed beef. The ACCC conducted additional inquiries in the period following the Statement of Issues, and these inquiries confirmed the ACCC's preliminary view. In particular, market inquiries indicated that the merged entity would continue to be competitively constrained by existing competitors such as Teys, Nippon, HW Greenham, Cargill and Australian Country Choice, and that the proposed acquisition was unlikely to substantially lessen competition in this market.

Conclusion

96. On the basis of the above, the ACCC formed the view that the proposed acquisition of Rockdale Beef by Swift would not be likely to result in a substantial lessening of competition in any relevant market in contravention of section 50 of the Act.