Terms of reference and conduct of the inquiry

Terms of reference

1. On 20 March 2009 the OFT sent the following reference to the CC:

   1. In exercise of its duty under section 22(1) of the Enterprise Act 2002 ('the Act') to make a reference to the Competition Commission ('the CC') in relation to a completed merger the Office of Fair Trading ('the OFT') believes that it is or may be the case that—

      (a) a relevant merger situation has been created in that:

      (i) enterprises carried on, by or under the control of **NBTY Europe Limited** have ceased to be distinct from enterprises carried on, by or under the control of **Julian Graves Limited**; and

      (ii) as a result, the conditions specified in section 23(3) of the Act will prevail, or will prevail to a greater extent, with respect to the supply of health food products through specialist retailers in the UK; and

      (b) the creation of that situation has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services, including the supply of nuts, seeds and fruits through specialist retailers.

   2. Therefore, in exercise of its duty under section 22(1) of the Act, the OFT hereby refers to the CC, for investigation and report within a period ending on 3 September 2009, on the following questions in accordance with section 35(1) of the Act—

      (a) whether a relevant merger situation has been created; and

      (b) if so, whether the creation of that situation has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services.

   3. In relation to the question whether a relevant merger situation will be created, the CC shall exclude from consideration one of the subsections (1) and (2) of section 23 of the Act if they find that the other is satisfied.

   (signed) Amelia Fletcher
   Senior Director, Mergers, Office of Fair Trading
   20 March 2009

Conduct of inquiry

2. On 20 March 2009, we posted on our website an invitation to express views to us about the merger, and, on 31 March 2009, we posted an administrative timetable for our inquiry.

3. We also invited a wide range of interested third parties to comment on the proposed merger. We sent detailed questionnaires to competitors, potential competitors, sup-

pliers and trade associations. We gathered oral evidence through 11 hearings with selected third parties. Submissions from third parties and summaries of hearings are on our website.

4. On 23 April 2009, we published an issues statement, which we posted on our website.

5. Members of the Inquiry Group, accompanied by staff, visited H&B's offices and packaging facility in Burton, along with H&B and JG stores in Loughborough, Ashby de la Zouch and Birmingham.

6. We received written evidence from NBTY and JG, and we posted a non-sensitive version of their main submission on our website. We also held hearings with both NBTY and JG.

7. In the course of our inquiry, we sent to NBTY, JG and other parties some working papers for comment.

8. We published our provisional findings on 22 July 2009, a non-confidential version of which is on our website.

9. We would like to thank all those who have assisted in our inquiry.

Interim measures

10. We took steps to ensure the separate and independent operation of the H&B and JG businesses during the course of our inquiry.

11. NBTY and NBTY, Inc. gave initial undertakings to the OFT under section 71 of the Act. Subsequent to signing the undertakings, NBTY requested a number of derogations, which are on our website.

12. The CC adopted these undertakings, along with the derogations granted by the OFT, when the merger was referred to us. We then considered whether any further changes were necessary to prevent pre-emptive action by the parties, which might prejudice the reference or impede the application of effective remedies at the end of our inquiry should they be required.

13. We assessed the need for further interim measures, including the appointment of a hold-separate manager or a monitoring trustee, taking account of the risk factors.[1] Given the evidence received from NBTY on the systems and structures in place at NBTY, Inc. and NBTY to ensure a continuing separation between H&B and JG, we did not believe that the risk factors requiring the appointment of a monitoring trustee were present in this case. However, we did consider it necessary to impose additional interim measures on NBTY, Inc., NBTY and JG to ensure that JG continued to be run as a separate business.

14. On 16 April 2009, we accepted interim undertakings from NBTY and JG, followed by interim undertakings from NBTY, Inc. on 27 April 2009. These revised undertakings superseded the undertakings given to the OFT. The revised undertakings, together with further derogations granted by us, are on our website.[2]

[1] *CC8*, Appendix A, paragraph 14.
[2] www.competition-commission.org.uk/inquiries/ref2009/holland/pdf/notice_interim_undertakings_nbty_160409.pdf; www.competition-commission.org.uk/inquiries/ref2009/holland/pdf/notice_interim_undertakings_julian_graves_160409.pdf; www.competition-commission.org.uk/inquiries/ref2009/holland/pdf/notice_interim_undertakings_nbty_270409.pdf.

The counterfactual

Introduction

1. This appendix describes the merger and each party's rationale for completing the transaction and sets out our analysis of the counterfactual, against which we compare the competitive effects of the merger.

Outline of the merger

Rationale for the sale of JG

2. Baugur, the former ultimate parent company of JG, is now in receivership. However, we spoke to two former members of Baugur's senior management team (the Baugur representatives). They told us that Baugur had decided to try to sell JG because the business was no longer strategically relevant to Baugur and because, in Baugur's view, JG's competitive position was deteriorating, in particular because other retailers were increasingly offering the kind of product which was available in a JG shop. The Baugur representatives told us that a wide range of alternative retailers, including Tesco, Boots, Pret A Manger and local garages were offering NSF and other snacks. This expansion in competing outlets had arisen following Gillian McKeith's television programme *You are what you eat* and an increasing awareness of healthy eating. The Baugur representatives noted that customers could now buy NSF from businesses [✄], with better locations and more buying power, and which could sell the product as an add-on to a basket of groceries or a general lunch offering. In contrast, customers of JG needed to make a separate visit to a secondary town-centre location.

3. The Baugur representatives also noted that, in recent years, JG had increased significantly the level of its promotions in order to sustain its sales, but this policy had led to pressure on profits, with tightening margins, increased costs, and limited or no prospects for sales growth.

4. The Baugur representatives told us that Baugur tried to sell JG in 2007 but the indicative offers it received were not commensurate with its price aspirations so the process did not proceed. Instead, it chose to refinance the business with Landsbanki and, in doing so, to separate out the financing arrangements for JG and WOC.

5. However, in 2008 the business deteriorated further. The Baugur representatives explained that this deterioration was due in part to the ongoing challenging trading conditions set out in paragraph 2, and in part to the level of debt with which JG had been burdened and the consequential demands for cash which the business had to satisfy.

6. The Baugur representatives told us that [✄].

7. Following the refinancing in November 2007, Landsbanki owned most of the debt in JG. The Baugur representatives told us that they believed Landsbanki was not willing to undertake a debt for equity swap, and preferred to explore a sale option. Therefore, in May 2008, JG's Chairman engaged Deloitte to assist in a possible sale of the company.

8. JG, Pyle Ltd (Pyle), Barney and Landsbanki (the Clients) engaged Deloitte to provide corporate finance advice in relation to the sale of JG. The Clients told Deloitte that their reasons for embarking on a sale process for JG were:

(a) to address the levels of debt within JG and Pyle (they noted that the level of indebtedness and the debt servicing requirement of JG and Pyle was high in relation to JG's earnings profile); and

(b) because Baugur wished to divest its smaller investments and focus on fewer, larger businesses.

Rationale for the acquisition of JG

9. NBTY told us that, in acquiring JG, it saw the opportunity to turn round a business that was in a parlous state, by utilizing its expertise in running successful retail businesses. It planned to introduce effective systems in all of JG's management functions, using a logical, common sense approach, and taking a long-term view rather than maximizing short-term cash. NBTY pointed to its success in turning round De Tuinen in the Netherlands and GNC in the UK which had both been loss-making when they were acquired in 2003.

10. NBTY had identified several areas for potential efficiencies, which were: [✂].

11. NBTY stated that it did not intend to rebrand the JG stores, [✂].

The merger process

12. Deloitte and its Clients identified [✂] potential buyers for JG, made up of [✂] market participants, [✂] financial buyers and [✂] private individuals. These parties were contacted in early June 2008. A few of the market participants, including NBTY, and most of the financial buyers and private individuals, signed confidentiality agreements in order to receive an information memorandum (IM).

13. One of the potential buyers was Mr Shutts, who at the time was the Managing Director of JG and a principal shareholder in the business. Mr Shutts told us that he and his management team expressed an interest in conducting a management buyout (MBO). As a result, [✂].

14. Interested parties were asked to submit a first round offer letter by 27 June 2008. Seven indicative offers were received. The bidders and their offers were as shown in Table 1.

TABLE 1 **Indicative first-round offers for JG**

	£m
NBTY Europe Ltd	[✂]
Private Equity A	[✂]
Private Equity B	[✂]
Nick Shutts (MBO)	[✂]
Private Equity C	[✂]
Private Equity D	[✂]
Private Equity E*	[✂]

Source: Deloitte and the bidders.

*The letter from this party included an alternative offer for a debt restructuring.

15. Following the receipt of first-round bids, conversations were held with each of the bidders. Following these conversations, the three bidders offering the greatest amounts were taken forward into a second stage: NBTY; Private Equity A (PEA); and Private Equity B (PEB). On 11 July 2008 these parties were sent a process letter inviting second-round offers. Further information was provided to these parties in an online data room and in a vendor due diligence report that had been prepared by KPMG, JG's auditor. Each of the parties were also invited to hold further meetings with management and to see JG's facilities in Kingswinford. The parties were also invited to submit due diligence questions, to which JG management replied.

16. By 31 July 2008, two second-round offers were received. NBTY offered £[✂] million [✂] and PEA submitted an unchanged offer of £[✂] million. PEB declined to bid at this stage as it believed that it was almost certainly competing against a trade buyer and it did not believe that it could make an offer which would be competitive. On 11 August 2008, after further due diligence, NBTY submitted a revised second-round offer of £[✂] million.

17. After considering the revised NBTY offer and PEA's offer, Deloitte and its Clients decided to proceed through a final period of due diligence with NBTY, [✂].

18. Late in the process, PEB reviewed the opportunity again and, on 4 September 2008, PEB submitted a further bid for JG. PEB's offer valued JG at £[✂] million (on an enterprise value basis), but it required Landsbanki to roll over a portion of its debt in the business. [✂]

Share purchase agreement

19. Under the share purchase agreement between Pyle and NBTY, signed on 16 September 2008, NBTY acquired all the issued shares of JG for £[✂] million. However, of this amount, £[✂] million was to be used to repay JG's existing debt, leaving £[✂] million as the maximum return to shareholders.

20. The final distribution of funds was to be agreed following the preparation of completion accounts, so £[✂] million of the consideration was paid into a retention account. NBTY told us that the parties had recently agreed a compromise settlement whereby [✂]. As a result, the effective acquisition price was £[✂] million.

The vendors after the merger

21. On 7 October 2008 the Government of Iceland dismissed the board of Landsbanki and put the bank into receivership. On the following day, HM Treasury froze Landsbanki's UK assets.

22. Barney (the parent company of Pyle) also owned WOC and Boaters Coffee Co Ltd (Boaters) through a subsidiary, Java Acquisitions Ltd (Java). However, these companies were also significantly leveraged and, on 22 December 2008, they were sold as 'pre-packs' out of administration. WOC changed its name to WOC Realisations Ltd and, on the following day, its restructured business was sold to Epic Private Equity LLP. Later, Barney and Pyle, which after the sale of JG and WOC had no trading activities, were also placed into administration with PricewaterhouseCoopers LLP (PwC).

23. In February 2009, Baugur filed for protection from its creditors and in the following month was placed into receivership.

The counterfactual

24. The CC guidance states: 'In applying the SLC [substantial lessening of competition] test, the CC will evaluate the competitive constraints on firms with the merger compared to the situation that would have been expected to prevail without the merger (sometimes referred to as the "counterfactual")'.[1]

25. In its submission to us, NBTY stated that, in the absence of this merger, JG would have failed, and its assets would have exited the market. NBTY argued that all the tests required by us for a failing firm argument were met in this case, and so no SLC could be expected to result from the transaction.

CC guidelines on failing firms

26. The CC guidance outlines the criteria against which a claim that the target company was failing should be assessed. The guidance provides that the following conditions should be satisfied:[2]

- the business must have been unable to meet its financial obligations in the near future; and
- the business must have been unable to restructure itself successfully.

The CC guidance also states:

> Whether and to what extent the CC will take the failing firm issue into account will depend on various circumstances. First it will need to consider whether any other persons might have acquired the firm, its businesses or any of its assets or wish to do so. A further consideration is how the sales of the failing firm, should it exit the market, will be redistributed among the firms remaining in the market. If without the merger they are likely to be dispersed across a number of other firms, then the merger, by transferring most or all sales of the failing firm to the acquirer, may well have a significant impact on competition in the market. In other cases the great majority of sales may be expected to switch to the acquiring firm anyway, in which case the merger may have little effect on competition.

27. We set out our considerations on each of the three tests for a failing firm argument in turn.

Test 1: JG's ability to meet its financial obligations

28. An account of the history, structure and financial performance of JG is set out in Annex 1 to this appendix.

NBTY's views

29. NBTY told us that JG had excessive borrowings, falling profits and cash flow, and difficulties in obtaining credit from landlords and suppliers who were increasingly concerned as debts became overdue. NBTY argued that, furthermore, neither

[1] *CC2*, paragraph 1.22.
[2] *CC2*, paragraphs 3.61 to 3.63.

Baugur nor Landsbanki, both of which faced severe financial difficulties of their own, were in a position to support the business anymore.

30. NBTY submitted that, prior to the merger, JG was in a precarious financial position and its finances were unsustainable. In particular, JG:

- was insolvent, according to its balance sheet;
- had suffered a prolonged and deteriorating period of losses;
- was experiencing severe cash-flow problems, with many creditors taking action which was impacting the business further; and
- had, for many months, been run with a focus on generating cash quickly to meet short-term demands irrespective of profits and strategy.

31. NBTY said that it identified these factors in its due diligence and they caused NBTY to [✂].

32. NBTY said that, from early 2008, JG had explored financing options but it had been unable to secure the additional credit it required to service its short-term cash demands either from its existing investors or new investors.

Duff & Phelps's report

33. NBTY asked a firm of financial advisers, Duff & Phelps Ltd (D&P), to assess the state of the JG business and to consider whether the three tests for a failing firm argument were met. D&P's report was completed on 23 January 2009.

34. D&P reported to NBTY that JG had been likely to fail under Baugur's ownership, because:

- JG's declining profitability had resulted in significant operating losses for the year to 31 March 2008 and the five months to 31 August 2008 (the last month-end before the merger);
- JG's weakening balance sheet had resulted in negative equity by 31 August 2008;
- JG's declining cash-flow performance had led to difficulties in servicing interest payments and JG was forecasting that it would breach its revolving credit facility in early October 2008; and
- KPMG would not have signed an audit opinion on a going concern basis for the year ended 31 March 2008 without the merger and a parental letter of support from NBTY.

35. D&P's report said that, in the year ended 31 March 2008, JG made a loss before tax of £517,000. It also noted that performance had declined subsequently, with a loss before tax of £5.8 million for the five months to 31 August 2008. In this five-month period, D&P noted that there was a loss at the EBITDA level of £1.1 million.

36. Although turnover increased during the period before the merger, this growth was due to new store openings and significant price discounting. As a result, gross margin fell significantly. D&P reported that JG's gross margin for the five months to 31 August 2008 was [✂] per cent, compared with [✂], [✂] and [✂] per cent in the years to 31 March 2008, 2007 and 2006 respectively.

37. The report highlighted other ways in which JG had sought to generate short-term cash flows, albeit at the expense of longer-term profitability, for example through rationing supplier payments and by opening stores in locations where landlords were offering cash incentives.

38. The D&P report showed that, at 31 August 2008, JG was in a position of negative equity and was generating negative free cash flows. D&P suggested that, despite an extension of £6.9 million to JG's credit facilities in June 2008, which was necessary to allow JG to meet its rent commitments, JG was still set to exhaust all its credit facilities by October 2008.

39. D&P did not consider that JG's performance was likely to improve because:

- JG's management had become increasingly focused on short-term cash management at the expense of sustainable profitability; and
- JG was now operating in an even harder trading environment, with a declining economic and retail outlook for the UK high street.

40. D&P thought that all JG's financing options had been explored and exhausted. D&P said that the financial difficulties of Baugur and Landsbanki made further support for JG from these sources very unlikely and, on its own, JG lacked the ability to raise new third-party debt.

41. D&P concluded that JG was unlikely to have been able to operate on a stand-alone basis without significant additional financial support. D&P estimated that JG's cash shortfall might have led the business to enter administration as early as October 2008.

42. Following the OFT's reference of the merger to us, D&P provided NBTY with an addendum to its report and, during the course of our inquiry, D&P provided NBTY with a second addendum. These reports supported D&P's initial conclusions.

Review of management accounts

43. JG gave us management accounts for the four years to March 2009. We combined these accounts and calculated for each month the 12-month rolling performance, ie the results for the year ended in each month. The advantage of this approach is that it reduces the effects of seasonality and makes underlying trends clearer, although it also dampens the effects of large monthly variances.

44. The management accounts did not reflect the adjustments to the statutory accounts, which KPMG required as part of its 2007/08 audit. These adjustments included adjustments to the 2007/08 figures and retrospective restatements of the statutory accounts for a couple of previous years. The largest adjustment required was a reduction of £1,884,000 for stock items which were found either not to exist or to be held at a value in excess of the lower of cost and net realizable value, resulting in a reduction of £516,000 from the reported profit for 2006/07 and a reduction of £1,368,000 from the profit of earlier years. Smaller adjustments relating to stock purchase records and utility accruals reduced the reported profit for 2006/07 by a further £430,000, with a corresponding impact on net operating assets. The fact that the management accounts did not reflect these adjustments meant that the profits in the management accounts for the three years from 2005/06 to 2007/08 were all positively overstated.

45. Most of JG's costs are fixed in the short term, including packaging facilities, distribution, stores (mostly rent and wages) and central costs. JG's only variable costs are the costs of raw materials and packaging materials, so the business needs to generate a large margin on these variable costs (the material margin) in order to cover its fixed costs.

46. Using data from the management accounts, we plotted rolling 12-month sales, material margin and overheads,[3] as shown in Figure 1. The difference between material margin and overheads is earnings before interest tax, depreciation and amortization (EBITDA).

FIGURE 1

JG sales, material margin and overheads

[✂]

Source: JG management accounts.

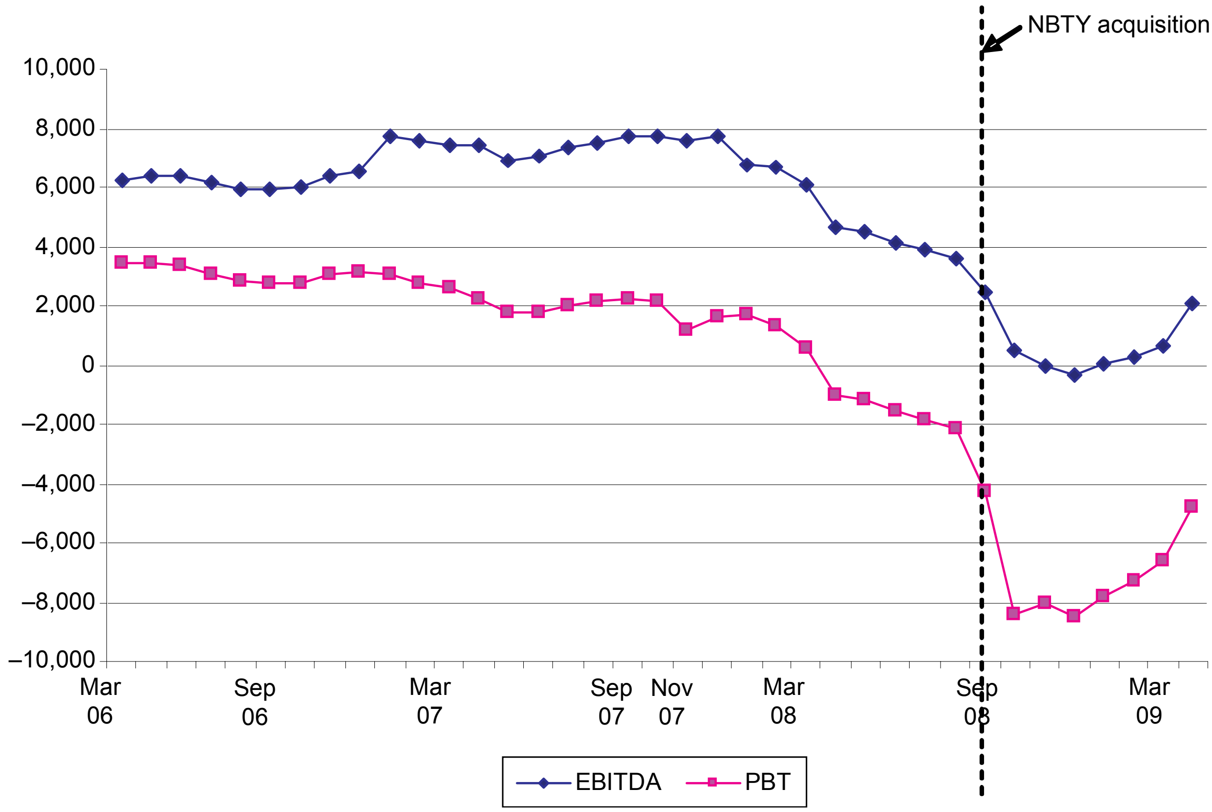
47. Figure 1 shows [✂].

48. In Figure 2, we show JG's EBITDA and profit before tax (PBT) on the same basis.[4] The difference between these two amounts is depreciation (which does not involve a cash outflow), interest and exceptional items.

[3]Overheads include all costs and expenses, except the cost of materials, depreciation and interest. There is no amortization cost in the business.
[4]The large fall in EBITDA and PBT in September is due to provisions against stock and leasehold improvements made at acquisition. Had these adjustments been accrued for before the acquisition, JG's trading performance before September 2008 would have been worse than shown on the graph.

FIGURE 2

JG EBITDA and PBT (12-month rolling)



Source: JG management accounts.

49. Figure 2 shows that EBITDA increased from an annual rate of £6 million in March 2006 to about £8 million in December 2006. JG maintained this level for 11 months until November 2007, the month of the refinancing, when it began to fall sharply. Mr Shutts told us that, from this time onwards, JG had to be managed to generate cash. There were quarterly payments of about £750,000 to be made to Landsbanki, and each quarter there were increasing rent payments. As a result, JG began to engage in significant price discounting, and other measures as set out in the D&P report (see paragraph 37). D&P noted that the effect of JG's frequent promotions was to reduce significantly its profitability. Discounting campaigns included having 50 stores a week running a '50 per cent off' campaign for two to three days. Mr Shutts told us that some stores, such as Leeds, were placed on a permanent '50 per cent off' promotion.

50. However, we noted that the fall in the material margin percentage began well before November 2007, as shown in Figure 1 by the widening gap between sales and material margin. The management accounts showed that the material margin percentage fell from [✂] per cent in 2005/06 to [✂] per cent in 2006/07. Several third parties, both suppliers and competitors, told us that there had been increases in commodity prices, which would have put pressure on margins, but the Baugur representatives told us that it was also the pressure from other retailers which forced JG to begin discounting more heavily in order to compete on price, so reducing its margins.

51. Most of the increase in JG's overheads took place in the 18 months from March 2007 to September 2008. The largest components of overheads were wages and rent and rates and, in this period, these costs rose rapidly as JG opened many new stores.

52. We believed that the short-term measures taken by management might have generated cash for a few months after November 2007, but they could not be sustained. We noted that, in May 2008, trade creditors were £9.1 million but two months later, in July 2008, they had fallen to £6.1 million; while, in August 2008, the value of stock fell from £9.2 million to £6.7 million. This evidence confirmed the D&P report, and evidence we received from suppliers, which suggested that JG was experiencing serious difficulty in meeting its payment obligations. JG's late payment of suppliers was resulting in low stock levels in stores as some suppliers had ceased trading with JG altogether. Management of JG told us that trading on this basis was incredibly difficult.

JG financing

53. When Baugur acquired JG in 2003, JG's debt finance was held both in JG and its immediate parent company Pyle. Pyle acted as a holding company and its debts were serviced by the cash flows of JG. Pyle had no other income.

54. Subsequently, there were several refinancing exercises. In 2005, [✂] extended its debt facilities to £[✂] million across the two companies and, in 2006, in order to fund the acquisition of WOC, Baugur restructured the debt again, increasing the facilities by a further £[✂] million.

55. In November 2007, following an aborted attempt to sell JG earlier in the year, Baugur refinanced the businesses again. Baugur's intention was to separate out the funding structures of JG and WOC, with Landsbanki replacing [✂]. As JG was the stronger business, it assumed most of the debt burden, almost £[✂] million split between JG and Pyle. WOC and its immediate parent company, Java, assumed much less. JG's financing structure is set out in Table 2.

TABLE 2 **Pyle/JG financing, November 2007**

£'000

	JG	*Pyle*	*Repayment schedule*
Landsbanki			
Loan A at LIBOR + 2.25%	[✂]	[✂]	2009–2014. Repayment end-loaded. Pyle repays first.
Loan B at LIBOR + 2.75%		[✂]	Repay on termination date (96 months from 1 November 2007).
Loan C at LIBOR + 3.25%		[✂]	Repay 108 months from 1 November 2007.
Mezzanine at LIBOR + 11%		[✂]	Can keep redrawing £4 million until payment can be made in full.
Revolving credit facility at LIBOR + 2.25%	[✂]		84 months from 1 November 2007.
Other providers			
HP facilities*	[✂]		
	[✂]	[✂]	

Source: JG.

*Represents the maximum amount of HP facilities utilized before the merger.

56. Using a LIBOR of 5 per cent in order to make a very rough estimate, JG's annual interest burden (excluding interest on the HP facilities) was about £3.1 million. This interest burden compares to operating cash inflows before capital expenditure of

£4.4 million in 2006/07 and £2.1 million in 2007/08. Mr Shutts told us that it was very unlikely that any other bank would have offered JG the amount of debt finance offered by Landsbanki at that time.

57. The vendor due diligence noted that JG breached its debt terms in December 2007 and March 2008 though, on both occasions, the covenants were waived by Landsbanki. From our review of JG's management accounts, it seems very unlikely that JG would have been able to generate sufficient cash to continue to meet its interest payments much longer.

Cash-flow problems in 2008

58. JG told us that, in 2008, in conjunction with its significant price discounting in order to generate cash, it also extended its supplier payment terms from 30–60 days to 90–100 days. JG acknowledged that, as a result of this strategy, both its stock range and its overall stock levels decreased as some of its suppliers ceased supplying the business.

59. D&P reported that five of JG's top ten suppliers, and 63 suppliers in total, had put JG on 'stop' and were refusing to supply further products. The report also said that a leading trade insurer, [✂], had stopped providing default insurance for sales to JG.

60. Two of JG's principal suppliers confirmed that JG had sought extended terms. Supplier A told us that JG had effectively funded much of its growth through its suppliers, while Supplier B told us that JG was at one time taking 90 days' credit. Prior to the acquisition by NBTY, both companies had taken steps to reduce the amounts they were owed by JG.

61. D&P also reported that only 305 of JG's 342 stores made their quarterly rent payments in June 2008, meaning that 37 stores were in default. JG showed us evidence from 16 landlords and their agents, which had either begun or were considering legal action in order to pursue their outstanding debts.

62. The following quarter's rent bill, costing about £3 million, was due on 25 September 2008 and was significantly in excess of JG's cash reserves at the time of the acquisition. [✂]

63. D&P noted other evidence of JG's cash constraints, including the cancellation of a direct debit to the Inland Revenue for £270,000 and the delay or cancellation of essential maintenance to its stores, including obligatory asbestos inspections.

2008 statutory accounts

64. KPMG, JG's auditors in 2007/08, confirmed that, without an undertaking of parental support or additional alternative financing, it would not have been able to sign an unqualified audit report on JG's accounts for the year to 31 March 2008 at the date of the signature, as the company, even on its own forecasts, was unlikely to be able to meet its financial obligations in the near future. KPMG told us that it was only able to sign an unqualified report when the merger had been completed and NBTY had given a letter of parental support.

Conclusion on test 1 of the counterfactual

65. In our view, JG's fundamental problems were that the business was substantially over-leveraged and that it had expanded excessively fast, leading to increased over-

head costs, which had run ahead of the revenue-generating potential of the business. JG had struggled for several months to maintain its debt payments to Landsbanki and management had resorted to increasingly desperate measures in order to generate cash, including significant price discounting, failing to pay suppliers on agreed terms and opening stores in new locations simply in order to receive landlord incentive payments. Many suppliers had ceased trading with JG except for immediate cash payment, reducing further JG's available working capital and causing JG's stock levels to fall. Several of JG's landlords were beginning to take legal action in order to pursue overdue rent payments. Prior to the acquisition by NBTY, JG's auditors could not sign off an unmodified audit opinion on the accounts to March 2008, as to do so required a belief that, at the time of signing, the business continued to be a going concern. At the time of the acquisition, though JG was still trading, it had negative net assets.

66. In these circumstances, we found that the JG business could not have survived much longer without, at least, a restructuring of its finances. Therefore, we have provisionally concluded that JG was failing and the first test of the failing firm argument is met.

Test 2: JG's ability to restructure itself

67. This test asks whether JG could have restructured itself successfully to return to being a viable business operating in the same market. (This is not the same question as whether another business could have restructured JG, which we consider under the third test: whether there was a less anti-competitive alternative to the merger.)

NBTY's views

68. NBTY submitted that there was no serious prospect that JG would be restructured. NBTY believed that Baugur and its advisers had considered, and discounted, all other serious prospects for restructuring JG prior to the merger. NBTY told us that, following a strategic review of JG in mid-2008, Baugur had evinced a clear intention to dispose of the business and to exit the market irrespective of whether the sale to NBTY proceeded. NBTY pointed out that Baugur had already shown a reluctance to restructure a failing business when it had sold MK One, a fashion retailer, for £1 in May 2008.

69. NBTY also noted that there were several issues which would have made a restructuring of JG problematic:

- JG's cash burn rate required immediate additional capital over the restructuring period, in particular because JG was forecasting to exhaust all its available credit facilities by early October 2008.

- JG was being run on the basis of short-term cash generation, resulting in problems with suppliers, stock outages, rent arrears, deteriorating margins and the cancellation of key contracts. Without any focus by management on profitability, new finance was unlikely.

- Out of the 263 stores opened before 31 March 2006, 35 stores were loss-making at the EBITDA level, and many of the stores which were opened in 2007 and 2008 were also loss-making.

70. NBTY pointed out that resolving JG's problems would have required a significant financial restructuring and, given the financial difficulties faced by Baugur and Landsbanki, these businesses were in no position to advance further funds. NBTY

argued that, given the state of the financial markets around August and September 2008, in particular following the collapse of Lehman Brothers on 15 September 2008, it was very unlikely that another bank would have been willing to issue new debt to JG. The worldwide financial crisis had already started and funds for even healthy companies had dried up.

71. Therefore, NBTY submitted that any suggestion that the business could have been successfully reorganized was fanciful and no such prospect existed.

CC evaluation

72. Our review of JG's financial condition in the spring of 2008 (see paragraphs 43 to 64 above) showed that JG was in considerable financial difficulty. The business required a change in strategy away from some of its short-term destructive practices (eg the significant discounting of sales, the extension of credit terms with suppliers and the opening of stores for the benefit of immediate cash inducements). However, before it could achieve these changes, it also required a financial restructuring to reduce its interest burden, and an immediate injection of capital to enable it to meet its liabilities, in particular its rent payments due in September 2008.

73. The Baugur representatives told us that, when Baugur began its strategic review of JG in the spring of 2008, it was aware that its equity in Pyle and JG had limited value. Baugur had considered alternatives to a sale, but it believed that Landsbanki would support neither a debt for equity swap nor the recruitment of a new management team for the business with a new business plan. The Baugur representatives told us that, in their view, Landsbanki was not prepared to provide new funding and, therefore, any restructuring exercise would have needed new funds from an equity backer.

74. The Baugur representatives told us that Baugur had been looking to exit JG because it believed that the business was being defeated on the high street by other retailers which were better positioned to serve consumer demands for healthy snacks, in particular the large supermarkets (see paragraph 2). Baugur had also decided to exit because it had decided at a strategic level to divest its smaller investments and to focus on fewer, larger businesses (eg in May 2008 it sold MK One and it made a series of disposals throughout the year[5]).

75. We considered whether JG could have restructured its debt but we agreed with the Baugur representatives that, given JG was struggling to pay its existing interest charge, no bank was going to offer new junior debt below Landsbanki, and no bank would offer to refinance Landsbanki and put in more debt. Mr Shutts confirmed that no other bank would have offered the amount which Landsbanki offered JG in November 2007 (see paragraph 56). Also, it seemed extremely unlikely that any third party would have provided funds to JG while the existing management team and strategy remained in place.

76. We also considered whether JG had any prospect of receiving new equity from Baugur but, given Baugur's financial condition, its stated intention to move out of its smaller investments and its demonstrated commitment to a sale process [✂], we believed this option was very unlikely.

[5]Including sales of a 31.4 per cent stake in Booker Cash & Carry, a 25.5 per cent stake in Moss Bros, Saga Film and Whistles.

Conclusion on test 2 of the counterfactual

77. For JG to restructure itself, it would have needed new funds from either Baugur or Landsbanki, which we believed was very unlikely to have been forthcoming. Therefore, we have provisionally concluded that JG could not have been successfully restructured and the second test of the failing firm argument is met.

Test 3: A less anti-competitive alternative

NBTY's views

78. NBTY told us that, if it had not bought JG on 16 September 2008, there was a material risk that no one would have bought it.

79. NBTY noted that, although the sale process had not been predicated on any expressed deadline, there had been a degree of urgency for the transaction to be completed. This urgency was not just because of JG's financial situation, but also because of concerns about the uncertainty created by it being publicly known that the business was up for sale. NBTY observed that, once management was aware that its attempts to buy the business as an MBO had failed (around the end of July 2008) there would have been a material risk that the existing management team might leave, adding further pressure for a prompt sale.

80. NBTY also noted that, in September 2008, the financial world was changing rapidly. NBTY told us that it had been the successful acquirer of the business because it had been the only bidder with a financeable proposal and with directly relevant retail experience. No other party had completed financial due diligence and was ready to complete a transaction in the week commencing 15 September 2008. NBTY observed that the transaction completed just one day after Lehman Brothers had filed for Chapter 11 bankruptcy protection and the ensuing worldwide liquidity crisis meant that banks would have been much less prepared to lend. As a result, any other non-cash buyers would have struggled to complete the acquisition, in particular affecting the bids from financial bidders. To the extent that financial bidders might have maintained some interest in the process, NBTY found it hard to believe that they would have been able to finance any deal after Lehman's collapse, in particular in the brief window prior to Landsbanki being taken into government ownership and Baugur filing for administration.

81. Rather, NBTY believed that, if it had not bought the business, JG would have gone into administration. NBTY told us that the administrators would have sought to maximize the returns to creditors but the options would have been limited for several reasons:

    (a) JG had almost no assets to sell apart from stock and shelving units as all the shops and tills were leased;

    (b) any reorganization of the business would have been unlikely (see test 2); and

    (c) a lot of retail property was coming on to the market at the same time from other failed firms, including other Baugur entities.

82. NBTY told us that, with no other options available, the JG business would have been liquidated, and its assets would have exited the market.

83. Therefore, NBTY submitted that the appropriate counterfactual against which to assess the competitive effects of the merger was that JG would have ceased to carry

on in business and would have exited the market. NBTY said that its intention, following the merger, was to maintain JG's branded stores (except those stores which were trading at a loss and could not be made profitable) and, compared with this counterfactual, consumers would benefit from a preservation of output (ie more retail floor space devoted to the specialist retail of NSF and other food products). NBTY submitted that there was no loss of competition (substantial or otherwise) against this counterfactual.

Alternative buyers for JG

84. We considered who else might have bought JG had NBTY not done so.

85. Seven bidders submitted first-round offers for the business and three bidders, including NBTY, submitted second-round offers (see paragraphs 12 to 18). Mr Shutts told us that, although he did not progress in the process because the price he offered in the first round was too low, he would have been willing to re-enter the process at any stage to complete an MBO.

86. We considered each of the alternative second-round bidders in turn.

Private Equity A

87. PEA made a second-round offer for JG on 21 July 2008, in accordance with the sale timetable. Its offer stated that:

- PEA had been working with retail consultants and two experienced retail executives to understand the business, to form an offer and to build a plan for the business. PEA continued to view an acquisition of JG as a management buy-in (MBI), with its two executives set potentially to become the Chairman and Chief Executive.

- PEA confirmed its first round offer of £[✂] million (on a debt-free, cash-free basis).

- PEA intended to reposition the product and the brand, but some internal and supply chain issues had to be resolved. PEA saw considerable upside potential for the business.

- PEA needed to carry out its own further due diligence, which it expected to complete by the end of August 2008. If it did not obtain exclusivity, PEA requested a break fee such that, if the vendors should complete a transaction with another party, the vendors would pay PEA £[✂] per week from 23 July 2008, in compensation for its due diligence costs, up to a maximum of £[✂]. Subsequently, PEA amended its request to a one-off break fee of £[✂].

- PEA intended to establish a 'newco' to make the acquisition, funded through a mix of equity and debt. PEA would provide the equity through funds which it managed. PEA had held talks with possible debt providers, and believed that it would not seek to obtain a high level of debt given the current environment, but it had not concluded any discussions. PEA said that it would welcome a conversation with Landsbanki to see if it would be interested in any ongoing involvement. However, PEA also repeated its offer that it would be prepared to consider funding newco entirely with equity and to refinance the business after completion in order to offer the vendor financing certainty.

88. PEA told us that it had insisted on a break fee as it had the impression that there was a trade buyer, which had a greater knowledge of JG and was likely to be ahead of PEA in the auction process. PEA had already incurred significant costs in terms of its own time in developing its bids and, in these circumstances, it was not prepared to incur further substantial costs without a break fee.

89. However, PEA told us that, had it been taken forward in a period of exclusivity, it was likely that it would have completed an acquisition. PEA told us that it had already conducted substantial commercial investigations into the business and its offer was genuine. PEA said that its outstanding work was confirmatory financial and legal due diligence, with some possible further commercial due diligence as well. PEA recognized that this further work might have led to a reduction in price but it believed that it had a reasonable understanding of the business already so it did not anticipate cutting its price significantly. PEA told us that it had maintained the value of its offer between its first-round and second-round bids because the information it had received in the meantime, in particular the vendor due diligence reports and further meetings with management, had confirmed its previous views, rather than revealing anything new. PEA told us that it would never undertake due diligence unless it had a serious intention to complete a deal, and most of the opportunities it looked at in due diligence would ultimately lead to a transaction, although sometimes with a reduction in price.

90. PEA told us that it was not relying on the availability of debt finance in order to complete the transaction. It had held discussions with possible debt providers in order to gauge the market and, as a result, it was not envisaging being able to obtain a particularly high level of debt financing. However, PEA's offer stated that it was willing to bridge the debt, ie to fund the acquisition entirely with equity and to refinance the business after completion, and this willingness remained throughout the process. PEA hoped that this offer provided the vendor with financing certainty. PEA also confirmed to us that it had made an allowance for an injection of new cash to fund the extra working capital needed in the business.

91. The Baugur representatives told us that the reason Baugur decided not to take PEA forward in the process after second-round offers was because of the break fee required by PEA and an expectation that the offer would be cut. Baugur believed that it was likely that NBTY would complete an acquisition, and probably at the highest price, so it was not necessary to incur the additional costs of funding PEA to remain in the process. The Baugur representatives told us that, had NBTY not been in the process, it was likely that Baugur would have taken forward PEA instead.

92. PEA is a generalist private equity house but it demonstrated real and credible interest in this acquisition, and reviewed the opportunity with an experienced team of advisers and consultants. PEA showed that it was keen to pursue the opportunity, but it was not prepared to incur significant costs if it was just a 'stalking horse' to a trade buyer. PEA told us that, if NBTY had not shown any interest in acquiring JG, the eventual outcome would have depended on the level of interest from other financial buyers but it was quite likely that PEA would have completed the acquisition of JG.

93. On the basis of the information which NBTY had seen about PEA's involvement in the sales process, NBTY submitted that, at the time of its last offer for JG, PEA had not conducted commercial or legal due diligence on JG, even at a basic level. NBTY said that, if PEA had conducted this due diligence, it would have revealed to PEA the true parlous state of the business. NBTY said that, following detailed due diligence, PEA would have decided that the opportunity did not match its investment criteria and it would not have proceeded with the acquisition.

94. We considered these arguments. We noted that PEA had carried out substantial work and had engaged retail consultants and two experienced retail executives prior to the submission of its second round offer for JG. However, we also noted that PEA requested approximately six weeks from the date of its second round offer to complete its detailed due diligence. We considered PEA's typical investment criteria and noted that, prior to JG's rapid decline following its refinancing in November 2007, JG was a profitable, mid-sized business with a scalable business model. Although JG was struggling in 2008, the underlying business continued to fit with the profile of PEA's preferred investments. We recognized that, if PEA had continued in the process and conducted its detailed due diligence, PEA might have concluded that the problems facing the business were so significant that it would not wish to complete the acquisition. However, we believed that it was far more likely that PEA would have completed the acquisition, albeit quite possibly at a lower price. We found that, had NBTY not been involved in the process to acquire JG at all, it was most likely that PEA would have become the vendor's preferred bidder in late July or early August 2008, and, in the absence of other bidders, would have completed the acquisition of JG by the middle of September 2008 at the latest.

Private Equity B

95. PEB told us that it submitted a first-round offer for JG of £[✄] million but, after conducting its own commercial due diligence, it believed that a price of about £[✄] million was more realistic. However, PEB told us that, at the end of July 2008, prior to submitting a second-round offer, it tried to ascertain whether this price would be sufficiently attractive to the vendors for PEB to be taken forward in the process. PEB said that it was informed that there were other bids and an offer nearer to £[✄] million (ie double PEB's revised price) was required in order to be competitive. As a result, PEB declined to make a second-round offer at this time and withdrew from the process.

96. However, later in the process, at the end of August 2008 when a transaction with NBTY was nearing completion, [✄]. PEB reviewed the opportunity again and had a further meeting with Deloitte and Landsbanki. As a result, on 4 September, PEB offered £[✄] million for the business.

97. PEB told us that, if it had been given exclusivity, it was highly likely that it would have completed a purchase of JG. PEB believed that it had a good understanding of the business, having reviewed the material in the data room, including some of the legal documentation relating to the property leases, and the vendor due diligence material. PEB had also seen the facilities and met twice with management. PEB told us that it had completed its commercial due diligence and its further work would have been confirmatory due diligence only, conducted by accountants and lawyers, and it would have been carried out quickly. PEB requested a period of 30 days for exclusivity, in which it would have completed this work and signed a deal. PEB told us that, in reality, it would have sought to complete much quicker, referring to one recent transaction which it completed in 11 days.

98. PEB told us that it had not spoken to debt providers, and hence its offer required Landsbanki to roll over some of its debt in the business. PEB said that, though in hindsight Landsbanki was clearly in some difficulties, it is very unlikely that Landsbanki would have wanted to see the business fail and be liquidated, which would have destroyed the value in its investment. PEB recognized that Landsbanki might have preferred to cash out its investment but PEB believed that the option for Landsbanki to retain some of its investment in JG under new ownership, with a more robust funding structure, would have been far preferable to the business failing. PEB also told us that it would have considered bridging the debt if Landsbanki had wanted

to exit its investment, but only after it had consulted some debt providers to ascertain what capacity there might be for debt in the business.

99. PEB told us that, in extremis, if JG had gone into administration before a transaction completed, it would still have been interested in acquiring the business.

100. PEB is an experienced acquirer and operator of retail businesses and has completed a high volume of similar transactions. PEB asserted that, if it had been granted exclusivity in September 2008, it is highly likely that it would have completed an acquisition of the business. PEB told us that if NBTY had never been in the process at all it was harder to say what the outcome would have been, as there might have been alternative financial bidders, but PEB asserted that it would have been at least one of the possible acquirers.

101. NBTY submitted that PEB's bid was not capable of being consummated as it required Landsbanki to roll over some of its debt in JG, which, given the financial condition of Landsbanki at the time, was unrealistic. However, as we noted in paragraph 98, we believed that the option of rolling over its debt in JG might well have been attractive to Landsbanki given the very undesirable alternatives of the administration or liquidation of the business. We recognized that it might have been difficult for PEB to find an alternative bank to put new money into JG in late September 2008, but we did not believe that this problem was likely to have been insurmountable (see paragraph 107).

102. We also noted that, had NBTY not been involved in the process to acquire JG at all, it was most likely that PEB would have submitted a second round offer on 21 July 2008, in which case it would have sought to finance an acquisition of JG in late July or early August 2008, rather than in September 2008 (see paragraph 107).

NBTY's views on the private equity bidders

103. NBTY submitted that there was very limited time for other bidders to obtain the necessary financing and to complete the remaining due diligence to complete an acquisition due to JG's impending cash crisis towards the end of September 2008, which put JG on the brink of administration. We agreed that, had JG not been sold prior to the point at which its September rent payments became due, it was possible that JG might have entered administration (see paragraph 113). However, we did not believe that this outcome was certain, particularly given the diverse number and geographic spread of JG's landlords, which would have made the process of forcing an administration more difficult. Also, we noted that the relevant period for our counterfactual assessment did not begin from the day NBTY completed its acquisition of JG on 16 September 2008. In the counterfactual we have to form a view of what would have happened to JG had NBTY never been involved in the sale process and, in this scenario, we believed PEA, PEB or both PEA and PEB would have been taken forward into a detailed phase of due diligence following second round offers on 21 July 2008. Given the evidence we received from PEA and PEB, we believed that, on balance, one of these parties was likely to have acquired JG by the end of August 2008, or certainly by the middle of September 2008, before the September rents became due.

104. NBTY also submitted that JG required a trade buyer with experience of operating a similar vertically integrated business in order to turn it around quickly. We were not convinced by this argument. We recognized the specific expertise of the NBTY employees seconded to JG since the acquisition, and noted their success, with the incumbent JG management team, in beginning to turn the business around, but we did not think that these skills and the relevant experience were unique to these

individuals. We also noted that the sourcing, packaging, distribution and retailing of commodity products is not unique to the businesses of H&B and JG. We believed that it is likely that a private equity acquirer would have introduced whatever management was necessary in order to make a success of its investment.

105. NBTY also submitted that any private equity buyer would not have been able to benefit from NBTY's trusted relationships with its suppliers and landlords. We agreed that an alternative buyer of JG might not have been able, at least initially, to secure as favourable credit terms with JG's suppliers as NBTY and, as a result, an alternative buyer might have required a greater investment of working capital into the business than the £[✂] million injected by NBTY. On the basis of JG's retail cost of sales in the financial year to March 2009 (£[✂] million), we estimated that, if an alternative buyer's credit terms were one month less favourable than the terms achieved by NBTY, the additional working capital required would be £[✂] million. However, we noted that this extra investment was only temporary as, in due course, the alternative buyer would have been able to demonstrate its creditworthiness and would have been able to extend the terms with its suppliers to levels comparable with NBTY. We also noted that the action most likely to restore the confidence of JG's landlords was JG's prompt payment of rent. The cash injection made by NBTY was sufficient to settle all JG's immediate operational debts and meet the September rent payments, so the same cash injection by any other acquirer should have had the same effect. We believed that, on this basis, a private equity buyer would have been willing to make the extra investment necessary and the only effect of JG's deteriorated trading relationships with its suppliers might have been a further reduction in the acquisition price it was prepared to offer.

106. JG noted that the eventual investment necessary to return the business to profitability would be significantly greater than the £[✂] million loan provided by NBTY so far. [✂] We noted that JG has already returned to being cash-flow positive without this significant investment, but we accepted that further investment was required, whether the business was under NBTY's ownership or another buyer. However, we did not believe that the requirement for an investment at this level in order to restore the business to profitability, or a further requirement for investment to develop the business in the future, would have been a surprise to a private equity bidder or a disincentive to invest.

107. NBTY also submitted that both private equity bidders would have found it difficult to raise any debt finance for an acquisition in September and October 2008, at a time when the financial markets were in turmoil and the credit markets were effectively closed. However, we noted that PEA had offered to bridge the debt (see paragraph 90) and PEB was seeking to retain the involvement of Landsbanki (see paragraph 98). We also noted that, even in the period of financial turmoil through the autumn of 2008, a significant number of mergers and acquisitions took place. We looked at data on Thomson One Banker and found that, even at this time, funds appeared to be available to complete transactions. If anything, there appeared to be a short-term peak in merger and acquisition activity. Furthermore, we also noted that the state of the debt markets in September and October 2008 was not necessarily the appropriate period to consider as, in the counterfactual, it was likely that an alternative private equity bidder would have secured financing for an acquisition in August 2008 and would have completed an acquisition of JG by the middle of September 2008 at the latest (see paragraph 103).

108. Lastly, NBTY submitted that a private equity buyer for JG would not represent a less anti-competitive alternative to NBTY acquiring the business because a private equity buyer would not wish to make the long-term investment necessary to turn round the business, and the highly leveraged structure typically used by private equity buyers

would limit the ability of the business to compete. However, we asked both PEA and PEB about their exit intentions and neither of these bidders viewed this opportunity as a quick investment to sell on in the short term. Both the private equity bidders recognized that there were significant problems with JG which needed to be addressed and, in doing so, they hoped to add value to the business. We noted that PEA did not regard a highly leveraged transaction as being appropriate for JG and it did not appear to us to be in the interest of either private equity bidder to replicate the mistakes from JG's recent past by imposing too much debt on the business and limiting its ability to compete. Rather, we were satisfied that an acquisition of JG by either PEA or PEB would represent a less anti-competitive alternative to the acquisition of JG by NBTY.

Management buyout

109. Mr Shutts told us that, in early 2008, Baugur told him that JG had to be sold because Landsbanki wished to exit its investment in the business, but he was welcome to make a bid.

110. Mr Shutts said that he gained advice from BDO and found five or six potential sources of finance for an MBO. He told us that one of these backers, [✂], would have provided finance for an acquisition at around £[✂] million, but he knew that this value would not be sufficient for Baugur and Landsbanki. Mr Shutts said that, moreover, as the timing for Landsbanki became more urgent, he was unable to persuade the vendors to allow sufficient time to allow his potential backers to undertake full due diligence. Mr Shutts told us that at one point in the process he had been offered JG by the Chairman of Barney if he could come up with £[✂] million in five days, but this was clearly impossible.

111. Nevertheless, Mr Shutts told us that, if NBTY had never been involved in the sale process at all, Baugur and Landsbanki would have had to consider all other options more seriously, including an MBO. Mr Shutts said that he was aware he would have been bidding against other financial parties, but he would have been very interested in acquiring the business back as he believed firmly that it had a strong and profitable future.

Other bidders

112. Besides the second-round offers from PEA and PEB, first-round offers were received from three other private equity bidders (see paragraph 14). Following receipt of all the first-round offers, conversations were held with all the bidders explaining how their offers were viewed by the vendors in the context of the other offers which had been received. On the basis of these conversations, the three alternative bidders decided not to make second-round offers for the business as they were aware that their bids would not have been competitive. However, had NBTY not been part of the process, and if the range of prices being offered was lower, any or all of these three alternative bidders might have continued in the process. The fact that these private equity houses made first-round bids demonstrated that they had some interest in acquiring the business.

Insolvency/administration

113. JG was sold before it ran out of cash but, on 25 September, it faced having to pay its quarterly rents, which would have required approximately £3 million. As noted in our analysis of the first test of the counterfactual (see paragraphs 28 to 66), JG's stocks were depleted, it was having difficulties sourcing new product from suppliers due to

cash constraints and several of its landlords were beginning to take legal action in order to chase outstanding debts. In addition, both Baugur and Landsbanki were facing their own growing difficulties. In this context, if the sale process was protracted, it is quite possible that JG might have been forced into administration.

114. We noted that WOC, which was also owned by Baugur, went into administration in December 2008 but was immediately sold to a former owner in a 'prepack' arrangement.

115. Pre-packed sales out of administration are popular when there is a company with severe financing problems but with an attractive underlying trading business. Such arrangements are also easier when there is a single principal creditor so that a buyer can negotiate with one party. In our view, both of these features were present in JG.

116. We noted that there were many similarities between the situations of JG and WOC. They were both specialist retailers operating from small high street stores. Both businesses had suffered declining profitability but JG appeared to be the stronger underlying business, which is why Baugur put most of the debt into JG in its November 2007 refinancing. The principal lender to both companies was Landsbanki.

117. Given the interest in JG generated through the sales process, in particular from financial bidders and management, and given Landsbanki's urgency for some cash out of the business, we believed that, had JG entered administration, it is highly likely that the business would have been sold in a similar way to WOC. We recognized that a prepackaged sale out of administration would not have been desirable for Landsbanki but we believed that it would have offered the bank a much better outcome than any alternative at that stage.

118. NBTY submitted that, in the event of administration, the business acquired by a private equity buyer would have been very different from the JG business pre-merger and may well have been irretrievably damaged. NBTY highlighted the loss of customer and supplier goodwill which would result, the possibility that some landlords might seek to repossess some of JG's more profitable stores, and the opportunity for an acquirer to remove unprofitable stores from JG's portfolio. NBTY said that a sale out of administration was likely to have been on a piecemeal basis, consistent with the outcome of other recent administrations of retail businesses, with little certainty that complete failure could have been avoided.

119. We noted that, in recent months, many retail businesses had gone into administration and observed that several of them had been sold as pre-packs out of administration to private equity buyers. We believed that the underlying attractiveness of JG's business (see paragraphs 121 to 133) meant that, even if customer and supplier goodwill was lost to some extent, a buyer for the business was still likely to be found. We also did not think it likely that JG's landlords would have repossessed its more profitable stores in the circumstances of a pre-pack administration as we believed they would have seen few, if any, opportunities to re-let the store premises in the short term, particularly given the economic and retail market circumstances at the time.

120. We agreed with NBTY that, if JG had been acquired out of administration, it is likely that the buyer would have chosen not to acquire between 40 and 50 stores, which were loss making, and the buyer may also not have acquired some of JG's non-contributing stores, depending on its assessment of whether these stores could be turned round. However, we noted that, although the continuing store portfolio in this scenario might be smaller than the portfolio pre-merger, it was not clear how it would

compare to JG's store portfolio under NBTY's ownership, as NBTY had still to determine which JG stores it intended to close. We recognized that it was likely that more stores would have been closed in the event of administration than in the event of a sale prior to administration, but we were not convinced that the extent of the store closures in this scenario would have significantly weakened JG's competitive position. Also we did not think that this weakened position would necessarily persist, particularly given the ambitions of private equity buyers to grow the businesses in which they invest. We continued to believe that, had JG gone into administration, it was likely to have been bought by a private equity buyer, and this outcome would still have represented a less anti-competitive alternative to the merger.

Performance of JG since the merger

121. Although our consideration of the counterfactual was focused on what would have happened to the business in the summer and autumn of 2008 had the business not been acquired by NBTY, we also considered the performance of the business in the period post-acquisition. In this period, JG has operated with adequate finances, albeit in a recessionary trading environment, and its performance in this period is therefore informative about the underlying attractiveness of the business.

122. Following the merger in September 2008, NBTY provided a cash injection of £[✂] million by way of a loan to JG to enable it to pay its overdue liabilities and to provide an adequate level of working capital. It also seconded two of its executives to JG, while Mr Shutts left the company.

123. We looked at the management accounts for the period since acquisition (October 2008 to March 2009).

124. Figure 3 shows JG's monthly retail sales for 2008/09 compared with 2007/08.

FIGURE 3

JG monthly retail sales

[✂]

Source: JG management accounts.

125. Figure 3 shows that 2008/09 sales were generally similar to the previous year. Sales fell behind slightly in December but moved above the prior year in January.

126. Figure 4 shows JG's monthly material margin percentage for 2008/09 compared with 2007/08.

FIGURE 4

JG monthly material margin

[✂]

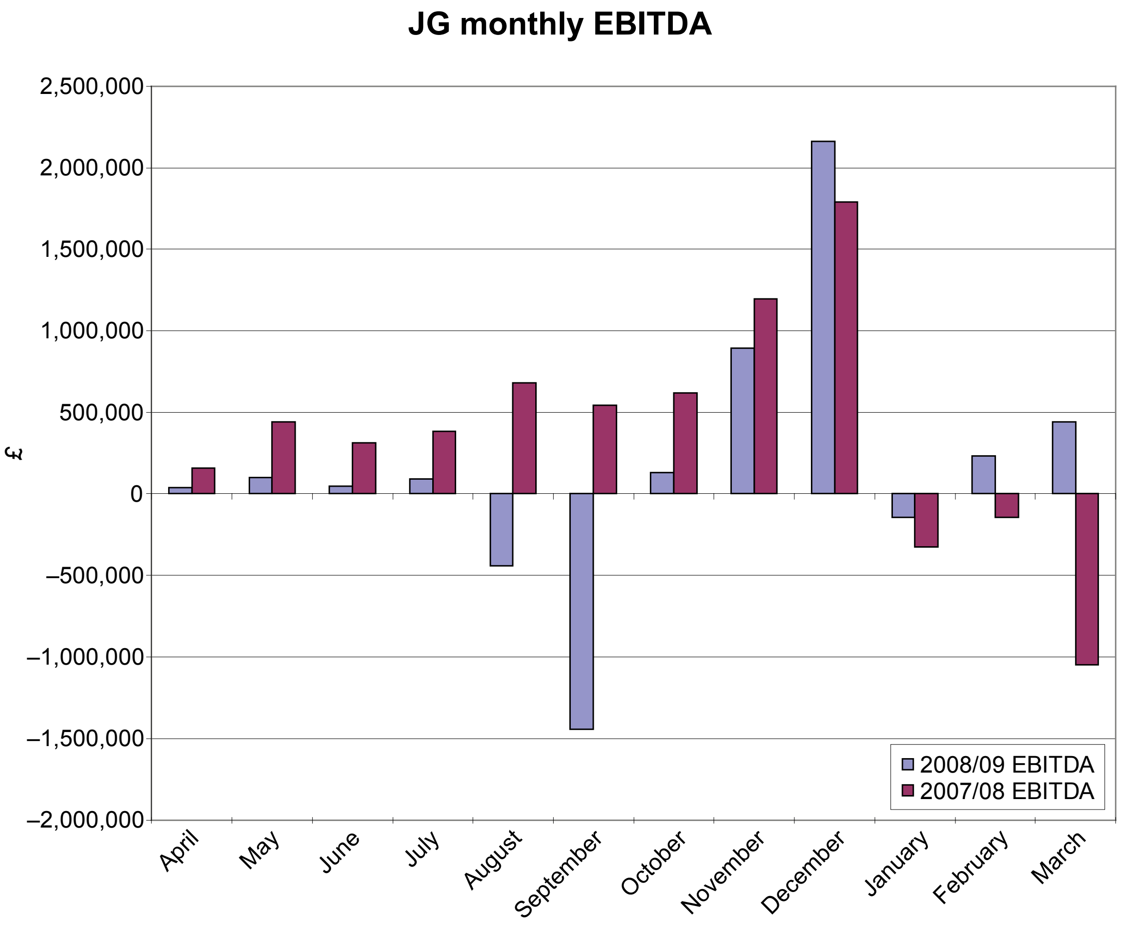
Source: JG management accounts.

127. Figure 4 shows the fall in margin between March 2008 and August 2008, which resulted from JG's strategy of sacrificing margin to generate cash income (see paragraph 49). In every month, margins were significantly below the level in the previous

year. However, in subsequent months, post-acquisition, margins have returned to the levels achieved by JG in the prior year, fluctuating around 60 per cent.[6]

128. Figure 5 shows JG's monthly EBITDA for 2008/09 compared with 2007/08.

FIGURE 5



Source: JG management accounts.

129. Figure 5 shows that JG's EBITDA was close to zero between April and July 2008, and became significantly negative in August and September 2008. However, following the acquisition, JG's EBITDA has returned to profitability and, from December 2008, JG's performance has been consistently and increasingly better than in the previous year.

130. Overall, the management accounts show that JG's sales for the six months to March 2009, which included the Christmas peak sales season, were 2 per cent higher than those for the same period in 2008. JG's material margin was higher than in the previous year and the business generated an EBITDA of £3.7 million. JG told us that it had not yet repaid any of the principal of its loan from NBTY, nor any of the accumulating interest on it, and it was not currently in a position to do so, but the acting Chief Executive of JG told us that the business was now cash-flow positive and there had been no need for him to seek additional funds from NBTY since the initial cash injection.

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[6]The margin in September 2008 is an anomaly due to a stock revaluation at acquisition.

131. JG's management accounts have not been audited but they suggest that JG has returned to profitability quickly, with new management and a cash injection from NBTY. This performance suggests that JG was not irretrievably damaged at the time of the acquisition and could have provided a new owner with a profitable business opportunity.

132. This performance has also been achieved in a period when NBTY has been limited in the extent to which it can intervene in the operations of JG due to the hold-separate undertakings in place. JG has not closed any of its loss-making stores and NBTY has not implemented any of its planned synergies.

133. While recognizing the achievements of JG's new management team, we believed that the injection of the necessary new working capital and the subsequent improvement in JG's trading performance could have been achieved by the alternative counterfactual acquirers, especially given the wider scope they would have enjoyed to restructure the retail estate in the short term after the merger.

Conclusion on test 3 of the counterfactual

134. In the absence of a bid from NBTY, we believed that, on balance, the most likely outcome for JG was that one of the alternative bidders would have bought the business. Two of these bidders demonstrated their intent to do so and there were further first-round bidders which might have continued to have some interest, including an MBO.

135. We believed that a liquidation of JG would have given Landsbanki the worst possible return and, given the extent of interest in the business from potential acquirers, Landsbanki appeared to have other, far more attractive, options available. It is possible that, with rental payments due on 25 September 2008, JG might have gone into administration but, if so, we believed that it was likely that it would still have been bought by one of the private equity bidders. In this scenario, JG might have been in a weakened competitive position, in particular because the acquirer is likely to have chosen not to acquire some unprofitable stores, but we believed it would still have represented a less anti-competitive alternative to the merger.

136. Although the financial markets were in turmoil during the summer and autumn of 2008, we noted that it was still possible to obtain finance, particularly at the amounts relevant for this acquisition, and, moreover, at least one of the bidders for JG appeared to be willing to buy the business on an all-equity basis.

137. We also noted that JG's post-merger performance has confirmed why the business was fundamentally of interest to acquirers as, with new management, a small amount of new cash and a reduction in its interest burden, it has been possible to return the business to being cash-flow positive.

138. Therefore, we have provisionally concluded that, in all likelihood, there was a less anti-competitive alternative for JG compared with a sale to NBTY and the third test of the failing firm argument is not met.

JG: history, structure and financial performance

Introduction

1. This annex sets out the recent history, structure and financial performance of JG.[7]

JG

History

2. In 1986, Mr Nick Shutts began selling nuts, herbs, dried fruits and other baking ingredients from a market stall in Moreton-in-Marsh, Gloucestershire. Gradually, he acquired further stalls in markets and shopping centres, before opening his first store, Food for Thought, at Brierley Hill in the West Midlands in 1987.

3. In 1993, Mr Nigel Morris joined Mr Shutts and they founded JG. Between 1996 and 2001, JG opened 85 new stores and established its head office, processing and distribution facilities at Kingswinford.

4. In 2003, Baugur acquired JG for £[✂] million through an intermediate holding company, Barney. Barney was the parent company of Pyle, which was the parent company of both JG and Boaters. At this time, Mr Morris left the business but Mr Shutts stayed as Managing Director, with a 20 per cent shareholding in Barney.

5. Following the acquisition by Baugur, JG continued to open new stores. In September 2000, JG incorporated an Irish subsidiary, JG (Killarney) Ltd.

6. In December 2005, Java, another Barney subsidiary, acquired WOC for £[✂] million. Java also bought Boaters from Pyle, its fellow subsidiary, combining this business with WOC.

7. WOC was run in parallel with JG and with the significant involvement of the JG senior management team. In March 2007, Barney appointed a new Executive Chairman, Kevin Lyon, who appointed a new Managing Director for WOC and, over the following six months, Mr Shutts reduced his involvement with WOC. At this time some of the management of JG acquired 15 per cent of the share capital of Pyle.

Facilities

Kingswinford site

8. JG's operations are managed from Kingswinford, West Midlands, from leasehold premises that combine a head office, processing and distribution facilities.

9. JG packs most of its bulk commodity products as it believes that costs are lower and there is greater supply chain flexibility and reliability, an ability to brand products

[7]Some of the JG data in this annex has been taken from the vendor due diligence report produced by KPMG on 4 July 2008. When this report was being prepared in June 2008, it was found that data for September 2006 was not available. Therefore, KPMG drew up some of its tables for the financial years to 31 March 2007 and 2008 with the September data in each year excluded, in order to allow comparisons to be made between the years.

under the JG label, and greater negotiating strength with suppliers. JG's packing facility employs about 60 people and usually operates on a 24-hour basis.

Store estate

10. Table 1 shows JG's continuous growth in store numbers.

TABLE 1 **JG: store numbers, five years to March 2009**

	2004/05	*2005/06*	*2006/07*	*2007/08*	*2008/09*
Own stores					
1 April	187	213	261	289	321
Additions	34	49	35	41	11
Closures	8	1	7	9	2
31 March	213	261	289	321	330
Concessions					
31 March	15	14	14	16	15
Total outlets					
31 March	228	275	303	337	345

Source: JG.

11. At 31 March 2008, JG had 337 stores, four of which were in the Republic of Ireland and one in Guernsey. Of the 332 UK stores, 154 were in high street locations and 120 in shopping centres. All these stores were operated by JG itself, and all of them were leasehold. JG also had 34 stores in outlet centres and 24 concessions, for example in garden centres.

12. By this time, JG had also developed a wholesale channel supplying its branded goods to garden centres (including 30 Wyevale centres) and to holiday centres such as Center Parcs. In 2007/08, this wholesale business generated sales of £[✂] million, ie about [✂] per cent of JG's turnover.

13. At 31 March 2008, JG had 35 loss-making stores from among its stores which had been open since before March 2006. JG also had 74 non-contributing stores from among those stores which had been opened in the last two years. JG regarded any store that generated a loss of more than £20,000 a year as irrecoverable and, at 31 March 2008, JG had six such stores. During 2007/08, JG closed nine loss-making stores.

14. At the time of the merger, in September 2008, JG had 345 stores, including one in the Isle of Man, one in Guernsey and a factory outlet in Kingswinford. JG's store estate was divided into 15 areas, each with an Area Manager. At this time, JG's store network employed about 1,400 full-time and part-time staff.

15. JG told us that it did not require a significant cash outlay in order to open and stock a new store. JG estimated that, in 2008/09, it cost approximately £[✂] to fit out each new store and £[✂] to provide each store with a full range of stock. JG said that it typically received a landlord contribution of about £[✂].

Products and suppliers

16. JG told us that it had about 900 individual SKUs which it classified into 47 product categories, which it classified into six overall product groups. Between 2006/07 and 2007/08, JG's sales increased in all six product groups, as a result of opening new stores and due to its significant promotional activity.

17. Table 2 shows JG's sales and material margins by product group for the last two financial years.

TABLE 2 **JG: sales and raw material margins, two 11-month years to 31 March 2008,* by product group**

	Product sub-groups (number)	*Sales £'000*		*Material margin £'000*		*Material margin %*	
		2006/07	*2007/08*	*2006/07*	*2007/08*	*2006/07*	*2007/08*
Nuts	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Branded products	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Confectionery	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other food†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other products	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: KPMG vendor DD report (from JG data).

*Data excludes month of September (see footnote to paragraph 1).
†This category mainly comprises seeds, crackers, herbs and spices.

18. Table 2 shows that nuts and dried fruit were JG's two largest categories, both by sales and material margin, representing over 50 per cent of the business.

19. Table 3 shows JG's sales and material margin for its 20 largest product categories in the year to March 2008.

TABLE 3 **JG's largest 20 product categories: sales and material margins, 11-month year to 31 March 2008***

Rank	*Product group*	*Category*	*Sales £'000*	*Raw material margin £'000*	*Cumulative raw material margin £'000*	*%*
1	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
2	Confectionery	[✂]	[✂]	[✂]	[✂]	[✂]
3	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
4	Confectionery	[✂]	[✂]	[✂]	[✂]	[✂]
5	Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]
6	Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]
7	Other foods	[✂]	[✂]	[✂]	[✂]	[✂]
8	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
9	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
10	Other foods	[✂]	[✂]	[✂]	[✂]	[✂]
11	Other foods	[✂]	[✂]	[✂]	[✂]	[✂]
12	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
13	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
14	Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]
15	Branded	[✂]	[✂]	[✂]	[✂]	[✂]
16	Nuts	[✂]	[✂]	[✂]	[✂]	[✂]
17	Confectionery	[✂]	[✂]	[✂]	[✂]	[✂]
18	Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]
19	Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]
20	Dried fruit	[✂]	[✂]	[✂]	[✂]	[✂]
	All other 27 categories		[✂]	[✂]	[✂]	[✂]
			[✂]	[✂]		

Source: CC from KPMG vendor DD report (from JG data).

*Data excludes month of September (see footnote to paragraph 1).

20. Table 3 shows that, although JG has 47 product categories, most of JG's material margin was generated by just a few of these categories: [✂] per cent of JG's material margin was generated from its top three product categories and [✂] per cent by the top 20. Nuts, confectionery and dried fruit made the largest contribution.

Financial performance

Long-term trends

21. Table 4 shows JG's financial performance from 1996 to 2008.

TABLE 4 **JG: financial performance, 13 years to March 2008**

£'000

Year ended March	*Sales*	*Gross profit*	*Operating profit*	*Sales growth %*	*Gross margin %*	*Operating margin %*
1996	3,661	992	248	N/A	27.1	6.8
1997	4,484	1,659	314	22.5	37.0	7.0
1998	5,985	2,528	243	33.5	42.2	4.1
1999	7,788	3,610	449	30.1	46.4	5.8
2000	10,719	5,424	665	37.6	50.6	6.2
2001	14,723	8,092	1,055	37.4	55.0	7.2
2002	18,335	10,555	1,131	24.5	57.6	6.2
2003	26,381	15,427	332	43.9	58.5	1.3
2004	31,658	19,706	1,797	20.0	62.2	5.7
2005	40,504	25,050	2,425	27.9	61.8	6.0
2006	52,315	31,207	3,698	29.2	59.7	7.1
2007	61,497	35,046	378	17.6	57.0	0.6
2008	69,688	37,595	–517	13.3	53.9	–0.7

Source: ICC Plum database (from statutory accounts).

22. Table 4 shows that, between 1996 and 2008, JG achieved continuous and rapid sales growth. Only in the last two years has JG's annual sales growth fallen below 20 per cent. JG's gross profit has also increased every year throughout the period, although its gross margin percentage peaked in 2003/04 and has been falling since. JG's operating profit peaked in 2005/06 but fell significantly in 2006/07 and became negative in 2007/08.

23. Table 5 shows JG's return on its net operating assets (RONOA), also referred to as return on capital employed (ROCE) from 1996 to 2008.

TABLE 5 **JG: components of return on net operating assets**

£'000

Year ended March	*Tangible fixed assets*	*Other operating assets (net)*	*Year-end operating assets*	*Average operating assets*	*Sales*	*Operating profit*	*Operating margin %*	*Asset turnover x*	*= RONOA*
1996	272	244	516	516	3,661	248	6.8	7.1	48.1
1997	429	219	648	582	4,484	314	7.0	7.7	54.0
1998	557	328	885	767	5,985	243	4.1	7.8	31.7
1999	758	–42	716	801	7,788	449	5.8	9.7	56.1
2000	1,244	64	1,308	1,012	10,719	665	6.2	10.6	65.7
2001	2,085	619	2,704	2,006	14,723	1,055	7.2	7.3	52.6
2002	3,346	343	3,689	3,197	18,335	1,131	6.2	5.7	35.4
2003	6,499	–373	6,126	4,908	26,381	332	1.3	5.4	6.8
2004	7,131	1,501	8,632	7,379	31,658	1,797	5.7	4.3	24.4
2005	8,233	1,540	9,773	9,203	40,504	2,425	6.0	4.4	26.4
2006	11,247	1,884	13,131	11,452	52,315	3,698	7.1	4.6	32.3
2007	13,140	–331	12,809	12,970	61,497	378	0.6	4.7	2.9
2008	13,349	116	13,465	13,137	69,688	–517	–0.7	5.3	–3.9

Source: CC from ICC Plum data (statutory accounts).

24. Table 5 shows that JG's RONOA peaked at [✂] per cent in the year to March 2000. After this time, JG maintained its operating margin until March 2006, though with some volatility, but its rate of asset turnover declined, mostly as the result of a tenfold increase in the level of its net fixed assets. From 2006 to 2008, JG's assets grew

more slowly than its sales but its operating expenses grew so fast that the company became loss-making.

Analysis of the range of NSF offered by different retailers

Introduction

1. This appendix describes our analysis of the range of NSF products offered by H&B, JG and some of the supermarkets.

Results

Number of SKUS

2. Figure 1 shows the median number of SKUs offered by each retailer from April 2001 to May 2009.

FIGURE 1

The median number of SKUs, April 2001 to May 2009

[✂]

Source: CC analysis.

3. We found that, overall, the median number of SKUs has increased over the period. We noted that, at the end of the period, H&B had a smaller number of SKUs than either JG or the three supermarkets in our sample.

Range differentiation

4. We investigated whether there was any substantial difference in the focus of the NSF products (eg organic NSF) and in the pack sizes of the NSF products offered by H&B, JG and four of the large supermarket chains.[1] Table 1 shows the number of organic NSF SKUs[2] stocked by each of these retailers, as well as the number of NSF SKUs available in large pack sizes.[3]

TABLE 1 **Number of organic and large-pack SKUs, 2008**

	H&B	*JG*	*[✂]*	*[✂]*	*[✂]*	*[✂]*
Organic	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
>499g	[✂]	[✂]	[✂]	[✂]	[✂]	
>999g	[✂]	[✂]	[✂]	[✂]	[✂]	
All products	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC analysis.

Note: SKU counts are based on sales data from 2008 and include some products that are no longer stocked.

5. We found that three of the supermarkets offered a similar, if not higher, number of organic SKUs to H&B. The fourth supermarket and JG offered fewer organic products. We found that JG offered substantially more products in large pack sizes than

[1]Although we had comparable data on NSF prices and range over the last few years from only three supermarkets, we had recent NSF product data from four supermarkets.
[2]The word 'organic' was in the product description.
[3]Pack sizes larger than 499g and 999g.

all the other retailers in our sample. We noted that H&B offered a similar number of large pack sizes to two of the supermarkets, and more than one of the supermarkets (pack size data was not available from the fourth supermarket).

6. We recognized that some retailers have a larger number of SKUs than others, so we also calculated each retailer's organic and large pack NSF range (as presented in Table 1), as a percentage of its total NSF range. The results are shown in Table 2.

TABLE 2 **Number of organic and large pack SKUs, 2008, as a percentage of the total range**

per cent

	H&B	*JG*	*[✂]*	*[✂]*	*[✂]*	*[✂]*
Organic	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
>499g	[✂]	[✂]	[✂]	[✂]	[✂]	
>999g	[✂]	[✂]	[✂]	[✂]	[✂]	

Source: CC analysis.

7. We found that organic products were more important to the ranges at H&B and two of the supermarkets than at JG and the other two supermarkets. We found that large pack sizes were most important in JG's range, but we also found that 500g packs were more important for H&B than they were for any of the supermarket retailers.

Distribution of range across the store portfolio

8. Although this data told us what, in theory, was available from each retailer's stores, we recognized that not every store operated by each of the retailers was likely to stock every product. Therefore, we investigated the distribution of each retailer's range across its store portfolio. We used the same store size classifications as used by the CC in its recent groceries market investigation,[4] so a convenience store was defined as a store with less then 280 sq metres of net sales area, a medium-sized store was defined by a net sales area between 280 and 1,000 sq metres, and a large store was defined by a net sales area above 1,000 sq metres.

9. We found that, in May 2009, all three supermarkets in our sample stocked a wider range of NSF products than H&B in both their large and medium-sized stores. We also found that one supermarket offered in its convenience stores a similar range of NSF to H&B, though less than the number offered by JG. The convenience stores of the other two supermarkets in our sample offered a more limited NSF range.

Significance of unique products

10. In order to compare the ranges of NSF products offered by H&B and JG, we also considered how important to each of them were the NSF products which they stocked but which were not available at any other retailer. This comparison was difficult as the retailers classified similar products in different ways. Even with this caveat, we found that there were very few products sold by H&B or JG which were

[4] www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm.

not also sold by a supermarket.[5] We also found that each of the unique products sold by either H&B or JG accounted for a very small proportion of their total NSF revenues.

[5] We found that, out of [✂] products for H&B and [✂] products for JG, there were 13 unique products not sold by the other retailers for which we had information. However, we believed that some of these products were sold elsewhere. NBTY told us that our analysis overstated the number of NSF products sold by H&B and JG because it included coated NSF products, NSF used in baking and some discontinued NSF products. We included coated NSF and NSF used in baking because there was considerable overlap between H&B and JG in these products and the distinction between products used for baking and snacking was unclear. We asked the supermarkets and other NSF retailers for data on these products as well. We recognized that, because we used data from 2008, some products had been discontinued but we used this data because we wanted to look at competition prior to the merger. (In applying our filter for competition in local areas (see paragraphs 5.67 to 5.75 of the main report), we used the most up-to-date information available.)

Analysis of the effect of entry by different retailers on existing Holland & Barrett stores

Introduction

1. This appendix describes our analysis of the effect of entry by different retailers on existing H&B stores. We analysed the effect on H&B of entry by JG, two pharmacy chains and some of the supermarkets. We would have liked to consider the effect of entry by independent health stores or other specialist retailers of NSF but we could not gather sufficient data from these parties to produce reliable results.

Description of our analysis

2. We categorized the supermarkets according to the number of NSF SKUs they stocked, as set out in Table 1. On the basis of the supermarket data analysed in our range analysis (see Appendix C), most large and medium-sized stores stocked at least 200 NSF SKUs. If a supermarket store expanded its range of NSF, and so moved from one category to another, we included it as an entry event in our analysis.

TABLE 1 **Categorization of supermarkets for the purposes of entry analysis**

Category	*Number of NSF SKUs*
AA	0
ABC	1–49
DEF	50–199
GHI	200+

Source: CC analysis.

3. We considered three geographic areas, a 1-mile isochrone around the incumbent H&B store, a ring from the boundary of this region out to a 10-minute drive-time from the incumbent H&B store, and a ring from the boundary of this region out to a 30-minute drive-time from the incumbent H&B store. Using average urban road speeds, we found 10 minutes' drive-time was approximately 2.4 miles and 30 minutes' drive-time was approximately 7.1 miles.[1]

4. We estimated separate equations for each potential competitor for each geographic area. We believed that this approach was valid because we did not identify any correlation between entry events, so omitting one type of entry should not lead to biased estimates for the effect of another type of entry. We controlled for changes in NSF demand which were common to all stores on a national and regional basis.

5. We observed the effect of entry on revenues in the four weeks after entry occurred. This approach recognized that shoppers take time to discover a new entrant and most shoppers make infrequent NSF purchases.

[1]We calculated distances by converting postcodes into geocodes and applying the Vincenty formula (see www.en.wikipedia.org/wiki/Vincenty's_formulae).

Results

6. Table 2 presents the results of our analysis of the cumulative effect of entry over one month on an incumbent H&B store.

TABLE 2 **Effect of entry on an incumbent H&B store over one month**

	Coefficient	*T-ratio*
jg_1mile	**–0.12**	**–6.44**
jg_10min	0.02	0.72
jg_30min	0.00	0.29
Hb_1mile	–0.08	–1.91
Hb_10min	0.01	0.34
Hb_30min	0.00	–0.23
drug_1mile	0.00	0.14
drug_10min	–0.01	–1.22
drug_30min	0.00	–1.07
multiple_AA_1mile	0.00	0.01
multiple_AA_10min	0.02	0.55
multiple_AA_30min	0.03	1.95
multiple_ABC_1mile	0.01	0.95
multiple_ABC_10min	0.00	0.86
multiple_ABC_30min	0.00	1.63
multiple_DEF_1mile	0.00	–0.44
multiple_DEF_10min	0.01	1.85
multiple_DEF_30min	0.00	1.32
multiple_GHI_1mile	–0.01	–0.56
multiple_GHI_10min	**–0.04**	**–3.93**
multiple_GHI_30min	**–0.01**	**–2.89**

Source: CC analysis.

7. We found that the entry by a JG store within 1 mile of an incumbent H&B store was associated with a 12 per cent reduction in the incumbent's NSF revenues. We found no statistically significant impact on an incumbent H&B store from the entry of a JG store opening up more than 1 mile away.

8. We found that entry by a supermarket offering at least 200 NSF SKUs within a 10-minute drive-time of an incumbent H&B store was associated with a 4 per cent reduction in the incumbent's NSF revenues. We found that entry by a supermarket within a 30-minute drive-time was associated with a 1 per cent reduction in the incumbent's NSF revenues. We found no statistically significant impact on an incumbent H&B store from the entry of a supermarket stocking at least 200 NSF SKUs within 1 mile.

9. On the basis of these results, we concluded that JG appeared to be H&B's closest competitor but H&B also appeared to face some competitive constraint from large and medium-sized supermarket stores. None of the other results from this analysis were statistically significant.

Glossary

Asda	Asda Group Limited, a subsidiary of Wal-Mart Stores (UK) Limited.
Barney	Barney Holdings Limited, a subsidiary of Baugur which acted as the UK holding company of **JG**.
Baugur	Baugur Group hf, an Icelandic company which bought **JG** in 2003.
Boots	Boots UK, a subsidiary of Alliance Boots GmbH.
Co-op	Co-operative Group Limited.
D&P	Duff & Phelps Limited, consultants commissioned by **NBTY**.
Deloitte	Deloitte LLP, advisers to the vendors in the sale of **JG** in the summer of 2008.
EBITDA	Earnings before interest, tax, depreciation and amortization.
GfK	GfK NOP Limited, a market research company, commissioned by **NBTY** to conduct a consumer survey.
GNC	**NBTY** operates Health & Diet Centres Limited (trading as GNC) in the UK.
H&B	Holland & Barrett Retail Limited.
JG	Julian Graves Limited.
KPMG	KPMG LLP, **JG**'s auditors.
Landsbanki	Landsbanki Íslands hf, the Icelandic bank which was the principal lender to **Baugur**, **Barney**, **Pyle** and **JG**.
Marks and Spencer	Marks & Spencer plc.
Mintel	Mintel International Group Ltd, a market research company.
Morrisons	Wm Morrison Supermarkets plc.
NBTY	NBTY Europe Limited, a subsidiary of NBTY, Inc.
NSF	Nuts, seeds and dried fruit.
OFT	Office of Fair Trading.
ONS	Office for National Statistics, the government department responsible for collecting and analysing UK statistical information.
Pyle	Pyle Ltd, a subsidiary of **Barney** and the immediate holding company of **JG** before the merger.
Sainsbury's	J Sainsbury plc.
SKU	Stock-keeping unit.

SLC	Substantial lessening of competition.
Somerfield	Somerfield Stores Ltd.
SSNIP	Small but significant non-transitory increase in price.
Tesco	Tesco plc.
TNS	TNS Global, a market research company.
VMS	Vitamins, minerals and food supplements.
Waitrose	Waitrose Limited, a subsidiary of John Lewis plc.
WOC	Whittard of Chelsea Ltd, a specialist tea retailer acquired by **Barney** through its subsidiary, Java Acquisitions Ltd, in January 2006.