

Anticipated acquisition by Virgin Active Holdings Limited of Esporta Racquets and Non-Racquets Holdings

ME/4994/11

The OFT's decision on reference under section 33(1) given on 11 July 2011.
Full text of decision published 5 August 2011.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Virgin Active Holdings Ltd ('Virgin Active')** is the holding company of a group which operates health and fitness clubs in the UK, Italy, Portugal, Spain and South Africa. Virgin Active currently operates 195 clubs worldwide, 72 of which are located in the UK.
2. **Esporta Racquets and Non-Racquets Holdings ('Esporta')** is a wholly owned subsidiary of New Esporta Holding Limited ('NEH'). Esporta operates 55 clubs, based predominantly in the Midlands and South of England, of which 37 are health and fitness clubs and the remaining 18 are racquet clubs.¹ Esporta's UK turnover in the latest financial year was £139.9 million.

TRANSACTION

3. On 22 April 2011, Virgin Active entered into a share purchase agreement with NEH to acquire Esporta for a consideration of £77.6 million.
4. The administrative deadline for OFT to make a decision on this case is 11 July 2011.

¹ Esporta's racquet clubs offer some or all of tennis, squash and badminton facilities.

JURISDICTION

5. As a result of this transaction Virgin Active and Esporta will cease to be distinct. The UK turnover of Esporta exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied.
6. The OFT therefore believes that it is or may be the case that arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RATIONALE FOR THE MERGER

7. Virgin Active submits that the transaction will enable it to expand its operations, both geographically and in terms of offering additional racquet facilities to members. The transaction will lead to cost synergies and allow for further investment in club facilities.

MARKET DEFINITION

8. Both the European Commission and the OFT have previously considered health and fitness clubs.²

Product scope

9. The parties overlap in the provision of health and fitness clubs.
10. The parties submitted that the relevant product scope is the provision of private health and fitness clubs which offer comparable facilities, but noted that public facilities also provide a strong competitive constraint.
11. In line with previous cases, this investigation found that health and fitness clubs provide a range of facilities to members which may include a gym, exercise classes, swimming pool, sauna, café/bar, crèche and beauty/spa treatments. The OFT has previously considered comparable clubs to include most or all of the seven listed facilities. However, while there are many gym-only clubs, there are fewer clubs with gym, exercise class and a

² Comp/M.3169, Bridgepoint Capital/Permira/Holmes Place, July 2003; OFT Decision 'Anticipated acquisition by Virgin Active Group Ltd of Holmes Place Health Clubs Ltd' October 2006.

swimming pool. In this case, the OFT has taken a cautious approach and considered these three facilities to be 'core' in order for clubs to provide a strong competitive constraint as a private health and fitness club.

12. As in previous decisions, the OFT again considered whether the product scope should be expanded to include public facilities, specifically with regard to the facilities offered and the type of membership offered. Privately owned clubs generally require members to sign up for a minimum period (usually one year) although there are some clubs which operate rolling contracts with a one month notice period.³ Publicly owned clubs generally offer facilities on a pay-as-you-go basis although more frequent users may sign up for different membership options which mean that visits are cheaper or even included in the cost of membership.
13. Third parties generally considered that the facilities offered by privately owned clubs are of a higher standard than those offered by publicly owned clubs and that staffing levels were higher, although it should be noted that many publicly owned clubs are operated by private companies under contract to the local authority and that there has been significant investment in some publicly owned clubs in recent years. The parties provided specific information on this point in relation to Kingston.
14. The OFT has therefore considered a relatively narrow product scope by which to assess the transaction, that is, private clubs with the 'core' facilities of a gym, exercise classes and a swimming pool. The extent to which clubs with fewer facilities offer a competitive constraint on clubs with more facilities, and the ability of publicly owned clubs to compete with privately owned clubs, is considered as part of the competitive assessment.

Geographic scope

15. Virgin Active and Esporta both operate health clubs throughout the UK, although Esporta's estate is concentrated in the Midlands and South East of England.
16. Prospective members will consider the location of a club on a local basis, generally choosing either to become members of a club close to work or to

³ The OFT undertook an investigation into Ashbourne Management Services in relation to gym membership contracts. Further details can be found at www.offt.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-current/ashbourne

home. Where corporate membership is offered, the location of the club is likely to be closer to work, although the availability of reciprocal visiting rights may mean that gym membership gives members access to a gym close to home (as well as close to work).⁴

17. The parties did not submit a view on geographic scope but adopted the same methodology as that used in the Virgin Active/Holmes Place case in their submission. In Virgin Active/Holmes Place, the OFT considered journey times of 15 and 20 minutes by foot (1.5 and 2km radii) and also by car/public transport centred around each of the parties' clubs in all areas.
18. No third party suggested that an alternative methodology should be used to assess the transaction, although one third party indicated that, due to the importance of location to members, a 10-minute radius should also be considered.
19. The evidence on the appropriate geographic market is mixed although it is clear that competition is focused at a local level. The information received from the parties has allowed the OFT to consider the number of clubs within a 15- to 20-minute walk time and the number of clubs within 10-, 15- and 20-minute drive times.

HORIZONTAL ISSUES

Closeness of competition

20. The OFT considered to what extent the parties could be considered as close competitors in terms of the facilities offered and membership options at their clubs. In general, both parties are considered to offer 'luxury facilities', together with David Lloyd, while other providers such as Fitness First and LA Fitness offer 'more affordable' facilities.⁵ Third parties stated they consider Virgin Active and Esporta to be close competitors because of their similarity in market positioning and service offering. However, the OFT notes that Esporta also offers racquet clubs in addition to its health and fitness clubs, whereas Virgin Active⁶ generally only offers health and

⁴ Third party feedback suggested that take-up of reciprocal rights is low, with only four per cent of members making use of these rights.

⁵ Keynote Market Report (2010), 'Health Clubs & Leisure Centres'.

⁶ Virgin Active has five clubs with racquet facilities; Clements Hall, East Dorset, Fulham, Moorgate, and West London.

fitness clubs.⁷

21. The OFT found little transparency in pricing. Membership charges are often only revealed after prospective members have visited the clubs and spoken to a membership adviser. Membership advisers may have some discretion in discounting from the headline prices either by offering different types of membership or special incentives to individuals to join up. In the main, the OFT found that Esporta clubs are more expensive than Virgin Active clubs.
22. The range of membership options may also vary by club. Virgin Active has twelve different membership options, including short-term memberships and off-peak memberships. While membership is generally offered on a 12-month contract, [].⁸ []
23. Due to the mix of evidence, the OFT has not been able to draw any conclusions on closeness of competition between the parties. Third parties noted that any assessment needed to be undertaken at a local level and this is set out below.

Shares of supply

National Issues

24. The parties have a combined share of supply of private clubs of 3.9 per cent (with an increment of 1.7 per cent) in the UK. Evidence provided by the parties, and supported by third party responses, indicates that the health and fitness sector more widely is large and highly fragmented in the UK.

Local issues

25. The OFT has assessed competition at the local level on the basis of a fascia test, consistent with previous cases. The OFT has taken a cautious approach and has considered in more detail those local areas where the merger would result in a reduction in fascia from five to four or less in a given area, on the basis of all private clubs with comparable core facilities – that is, a gym, exercise classes and a swimming pool – on the basis of a

⁷ The five overlap clubs identified – Chislehurst, Kingston, Leeds (Light), Sheffield Woodseat, Wimbledon – are health and fitness clubs and offer similar facilities including the 'core' facilities of a gym, exercises classes and a pool.

⁸ []

15- to 20-minute walk and a 15- to 20-minute drive time around each of the parties' clubs.⁹

26. Applying this test, the OFT identified the following five areas where the transaction raises cause for further analysis:

- i. Chislehurst
- ii. Kingston
- iii. Leeds (Light)
- iv. Sheffield Woodseat
- v. Wimbledon.

Chislehurst

27. The Virgin Active club is located in Bickley with the Esporta club some 9km away in Chislehurst, so the parties overlap only if a 15-minute drive time is adopted. The Esporta club is an adults-only club and advertises itself as the only such club in Kent. The merger would result in a reduction in fascia from five to four around both the Esporta club and the Virgin Active club. However, within this 15-minute drive time, there are at least two public clubs offering the 'core' facilities. If the drive time is increased to 20 minutes, a further two private clubs and at least a further five public clubs with 'core' facilities have been identified. On this basis, post-merger there would be a reduction in fascia from seven to six or higher. In addition, the OFT considers that there are a number of other private clubs in the area which, despite offering fewer facilities, nevertheless offer sufficient facilities to exert a degree of competitive constraint on the parties.

28. None of the third parties who were contacted during the course of this investigation raised any competition concerns in relation to this local area.

⁹ Once these areas were identified, the OFT also considered a 10 minute drive time but found that it did not alter the findings of the initial analysis.

Kingston

29. In Kingston, the Virgin Active and Esporta clubs are located within 2km of each other, and on a 'walking distance' basis the transaction would result in a reduction in fascia from three to two for both clubs.
30. One third party raised concerns over the closeness of the two clubs while another raised concerns over prices – that the merged party would seek to undercut other operators in the local area. However, looking at the competitive constraint that would remain on the merged party from outside private gyms, the parties provided internal documents that identified a number of public gyms as direct competitors to their clubs in Kingston. There is a privately-run public gym within 0.5km of the parties' gyms which offers extensive facilities, including an equivalent sized pool, a well-equipped gym, health spa and squash courts and therefore is expected to provide a strong competitive constraint on the parties' clubs post merger. Further, the OFT noted that a new low-cost facility had recently opened in the town and that it was expected to attract members from existing clubs. Although this club offers fewer facilities, for example, it does not have a pool, it is expected to provide a degree of competitive constraint on the merged entity post merger.
31. The parties argued that many residents of Kingston will commute to and work in London so that clubs in central London will provide a competitive constraint on clubs in the Kingston area. To support their view, the parties analysed Virgin Active's membership data for Kingston and found that [30-40] per cent of Virgin Active members resident within a 10-minute drive time of the Kingston club do not use that club but use another Virgin Active club, such as those in central or south west London. This evidence provides some support for the view that residents may choose to use a club outside of Kingston, perhaps close to work, thereby providing a degree of competitive constraint on those clubs in Kingston.
32. Finally, the parties submitted that the more appropriate geographic area in Kingston would be measured by a 15- to 20-minute drive time, rather than walking distance. To support this view, the parties provided information to show that for each of the clubs (which have extensive parking facilities) the catchment area within which the great majority of the parties' customers are located is over [zero to five] km. On this basis, the merger would result in a reduction in fascia of nine to eight or higher based on the

core facilities at private clubs within a 15-minute drive time of the two clubs.

33. Two third parties raised concerns in respect of this area and these have been discussed above.

Leeds (Light)

34. There is one Virgin Active club and one Esporta club in Leeds. On a walking distance basis, the transaction would result in a reduction in fascia count from five to four within a 2km of both clubs. However, there is a public gym located within walking distance of the two clubs that offers equivalent facilities to those of the private clubs and hence is expected to provide a competitive constraint on the parties post merger. Further, there are twelve privately owned clubs in the centre of Leeds that offer some, but not all, of the facilities to those offered by the parties.
35. One customer noted that the parties are the two largest operators in Leeds offering stand-alone health club facilities that include a swimming pool and other services. However, the customer also noted that there were other providers locally offering similar facilities, albeit on a smaller scale, for example, as part of a hotel. There are also two large gym-only providers in the city centre. The customer did not believe the merger raised any competition concerns.
36. The parties submitted that for each of these clubs the great majority of members live within a boundary of [five-10] km and would indicate that drive times are more relevant than walking distances in this area. If drive times are considered, there are a further 14 clubs, both public and private, offering the 'core facilities' within 20 minutes drive time of both clubs. The OFT therefore considers that there is sufficient competition in the centre of Leeds (and its outskirts) to provide a constraint on the parties post-merger.
37. Only one third party provided comments in respect of this area and these have been discussed above.

Sheffield Woodseat

38. In Sheffield, the Virgin Active and Esporta clubs are located within 2km of each other. On a 'walking distance' basis, the transaction would result in a reduction in fascia count from two to one around the Esporta club and from

three to two around the Virgin Active club. However, both clubs are located on the outskirts of the city of Sheffield. The parties submitted that for each of these clubs the great majority of members live within a boundary of [five-10] km and would indicate that drive times are more relevant than walking distances in this area. If a 15-minute drive time is considered, at least four private and four public clubs with the 'core' facilities are identified around the parties' clubs. On this basis, the OFT considers there is sufficient competition to provide a constraint on the parties post merger.

39. None of the third parties who were contacted during the course of this investigation raised any competition concerns in relation to this local area.

Wimbledon

40. In Wimbledon, the Virgin Active and Esporta clubs are situated within 2km of each other. On a walking distance basis, the transaction would result in a reduction in fascia count from five to four within 2km of the Esporta club and from three to two around the Virgin Active club. However, there is at least one public gym located within walking distance of the two clubs that offers equivalent facilities to those of the private clubs and hence is expected to provide a competitive constraint on the parties post merger.

41. The parties submitted that, similar to Kingston, the more appropriate geographic area in Wimbledon would be measured by a 15- to 20-minute drive time, rather than walking distance. To support this view, the parties provided information to show that for each of the clubs the catchment area within which the great majority of the parties' customers are located is over [zero - five] km. When a 15-minute drive time is considered, at least five private clubs with the 'core facilities' are identified. On this basis, the OFT considers there is sufficient competition to provide a constraint on the parties post merger.

42. None of the third parties who were contacted during the course of this investigation raised any competition concerns in relation to this local area. One respondent considered there was plenty of competition in the area.

BUYER POWER

43. The OFT contacted several third party corporate members during the course of its investigation. Some customers indicated that they would

consider switching to an alternative provider if prices increased by five-10 per cent. However, given there are sufficient post merger competitive constraints in each local area, no conclusion need be drawn on buyer power.

BARRIERS TO ENTRY AND EXPANSION

44. Third parties estimated that the cost of building a new club may be as little as £100,000 or as much as £30 million, dependent on location and range of facilities. Marketing costs for a new club were estimated to be in the region of £100,000. There is evidence of entry by low-cost providers – this was noted in the parties' internal documents and was also mentioned by third parties.
45. Given there are sufficient post merger competitive constraints in each local area, no conclusion need be drawn on barriers to entry and expansion.

THIRD PARTY VIEWS

46. The OFT received a limited number of third party responses to its enquiries; responses were evenly split between customers and competitors (national and local). Few third parties raised any concerns regarding the transaction.
47. One national corporate customer expressed concerns that membership fees may rise as a result of the merger but no other customer raised any similar concerns.
48. Third party responses relating to the individual overlap areas have been included in the competitive assessment above.

ASSESSMENT

49. Both parties operate health clubs in the UK. The OFT has considered private clubs offering a range of 'core facilities', including a gym, exercise classes and a pool to comprise a distinct frame of reference. However, the OFT has had regard to the competitive constraint exerted on these private clubs from other providers, including public gyms.
50. The effects of the merger have been considered at a national and local level. At the local level, the OFT has considered 15- and 20-minute walk

and drive times centered around both the Esporta clubs and the Virgin Active clubs.

51. At the national level, the parties have a combined share of supply of 3.9 per cent (with an increment of 1.7 per cent). In addition, evidence provided by the parties, which has been supported by third party responses, indicates that the health and fitness sector is large and highly fragmented in the UK.
52. At the local level, there are five areas where the merger would result in a reduction in fascia from five to four or less.
53. In the four areas of Kingston, Leeds (Light), Sheffield Woodseat and Wimbledon, the merger would result in a reduction in fascia from five to four or less within a walking distance of 2km. However, a detailed analysis of each area indicates that within 15- or 20-minute walk times there are publicly run facilities and other fitness centres that provide a degree of competitive constraint. Further, with regard to the Kingston area in particular, the parties submitted that their clubs are likely to be constrained, to some extent, by the clubs located close to their members' place of work. Furthermore, evidence before the OFT suggests that distances measured in drive times are relevant, and in some cases more relevant than walking distances, in these areas. On the basis of 15- or 20-minute drive times, the merger would result in a reduction in fascia of six to five or higher based on private clubs offering the core facilities in all four areas.
54. In Chislehurst, the parties overlap if a 15-minute drive time is used and results in a reduction in fascia of five to four. However, there are a number of private clubs in the area which, despite offering fewer facilities, are considered to exert a degree of competitive constraint on the parties. Further, if the drive time is increased to 20 minutes, the reduction in fascia is seven to six.
55. Therefore, taking into account all of these factors, the OFT considers that sufficient post merger competitive pressure is expected to remain to discipline the merged entity.

56. No significant competition concerns regarding the merger were raised by third parties.
57. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

58. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.