Competition & Markets Authority

POUNDLAND/99P STORES MERGER INQUIRY

Summary of hearing with TJ Morris (Home Bargains) on 23 June 2015

Background

1. TJ Morris Limited (TJ Morris), which traded as Home Bargains, was a value general merchandise (VGM) retailer with a multi-price point (MPP) business model. It had been founded 40 years ago and was a family-owned business. It had begun with one store in Liverpool and had grown to its current scale of 390 stores across the whole of the UK. The majority of its stores were in the Midlands and the North of England, the South of England being the least well covered part of the country. It planned to expand its operations in the South, and had invested in a large warehouse in Wiltshire that would be capable of supporting [✂] stores. It was growing at a rate of [✂] a year, opening [✂] a year, and was planning to expand to [✂] stores across the UK within [✂] years.

2. TJ Morris's stores ranged in size from 3,000 ft^2 to 25,000 ft^2. The smaller stores tended to be older and it now focused on opening [✂]. The ratio of branded and own-label goods that it sold was [✂] and this had remained relatively stable over the past five years. Other than seasonal changes, the categories of products it sold were also relatively stable although it had recently begun offering fresh and frozen food. In the smaller stores, it tended to sell the smaller products only, and would not stock larger items, such as furniture or large toys.

3. TJ Morris had not changed its approach to consumers in the last few years. Its plan, in relation to growth and pricing, had altered as a response to significant changes in the wider retail sector. As it was not a single-price point (SPP retailer) and did not want to be seen as such. Its approach was to sell regular size packs from manufacturers, rather than specially sized packs produced for a 99p/£1 sale price. Its main aim was to offer good quality at a good price. Its sales records showed that customers had been spending just over £1 per product at its stores for some time but that customers' bought a number of products at price points both higher and lower than this.

4. TJ Morris said that the opening of a store by any competitor in the same location as one of its stores would likely result in loss of sales. Given the large

fixed costs involved in the retail sector, any loss of sales would likely result in a proportionately larger loss of profit, and that small gains and losses in sales could massively affect profitability. If a small number of competitors left the market, it would give remaining companies the potential to increase profitability significantly.

5. TJ Morris said that companies that were growing and opening a lot of stores, for example Poundland, Poundworld, B&M and 99p Stores, would have the most impact from new openings, and that the larger and closer the new store was, the more impact it would have on the existing store. Depending on the area, the impact of entry on sales could range [✄].

6. TJ Morris thought the impact of other stores on its sales would also depend on the extent that the range of products offered overlapped. It felt that its customers were not concerned about whether the price of an item was £1 or £2, but whether it offered them good value.

7. TJ Morris said that a number of SPP retailers (Poundworld, Poundland and 99p Stores) had been actively seeking to grow their store estate and that this seemed to be motivated by a desire to either sell the company or float it on the stock market. Similarly B&M had achieved significant growth and floated.

Competition

8. TJ Morris said that at category level, there was significant overlap between SPP retailers and MPP retailers, but the former tended to have special pack sizes developed by the manufacturers specifically for this type of retailer, while the latter tried to buy normal size packs. It did not think that customers made a distinction between pack sizes though and what mattered to them was a low unit price.

9. The average price of the products sold by TJ Morris was [✄] price and did not want to be perceived as a pound shop.

10. TJ Morris commented that Wilkinson was not a discount retailer, as it did not compete on price.

11. TJ Morris said that 99p Stores' Family Bargains tried to emulate the approach of MPP retailers. It thought it likely that Poundland and other SPP retailers would also be forced by market conditions to offer MPP goods in the future. TJ Morris cited the example of Poundworld, which had previously launched an MPP retail business called UK Discount and was now also offering products at a price different from £1 within its Poundworld stores. Its view was that the SPP business model had benefited from the growth that had taken place in

China. Had raw materials and labour costs and inflation in China started to increase, there would be pressures on margins. With profit margins of 4 to 5% and an inability to increase prices or decrease package sizes beyond a certain point, these companies were vulnerable to small cost increases.

12. TJ Morris noted that UK Discount had not been successful, as Poundworld did not have access to a good enough product range. Its view was that going forward Poundworld would rebrand all its store as Poundworld, sell the vast majority of its products, say 70%, at £1 and the rest of its products at other prices.

13. TJ Morris was not aware of any occasions when Poundland or 99p Stores had reacted to specific actions it had taken but it had not closely followed either Poundland or 99p Stores' behaviour.

14. TJ Morris regarded Aldi and Lidl as competitors to the supermarkets, MPP and SPP retailers in the categories where they overlapped. These two retailers' real strength was in food, which was not Poundland's focus.

Customer behaviour

15. TJ Morris did not carry out analysis of customer behaviour however it thought that customers no longer had reservations about shopping in discount stores. Certain customers would visit all of the discount stores in their local area and in general people shopped around more than previously, because there were more discount retailers to choose from. It did not feel that shoppers had any particular loyalty to one retailer and considered that their shopping habits were primarily driven by the prices of the goods offered.

16. TJ Morris did not think that customers would travel out of their way to visit a Poundland or Home Bargains shop but would visit one if it was conveniently located for them or they were visiting other retailers in its vicinity.

The transaction and potential effects of the merger

17. TJ Morris had not considered buying 99p Stores. When asked how competition would evolve in a scenario where the merger did not take place; it referred to the price wars that had previously occurred between 99p Stores and Poundland. These price wars had an impact both on the profit margins of Poundland and 99p Stores but also more widely on other VGM retailers such as TJ Morris.

18. TJ Morris felt that the main concern arising from the merger from the CMA's perspective should be the closure of stores. It felt this was very likely

wherever there were two stores in the same locality. The merged company would also have increased buying power.

TJ Morris's approach

19. TJ Morris's decisions on price, product range and quality of service were made centrally. [✄]

20. TJ Morris said it [✄].

21. TJ Morris sought to stock products for which there was much demand, including for everyday use (food, home and household products) and seasonal products. [✄]

22. [✄]

23. TJ Morris said it [✄].

24. [✄]. Its focus was on running an efficient operation and offering low prices and good service across its stores.

25. In relation to operational costs, TJ Morris was different from many other retailers in that it [✄].

Entry and expansion

26. Its choice of a new store location was largely driven by [✄].

27. TJ Morris said that larger stores of around 20,000 ft^2 were much easier to find on retail parks rather than high streets, where stores were typically 15,000 ft^2 or smaller. There was a reasonable supply of 5,000 to 6,000 ft^2 stores on the high street and in general it was easier to obtain high street stores than 20 years ago, although there was still a lot of competition for suitable locations, as a number of MPP retailers, the SPP retailers (Aldi, Lidl and Iceland) were expanding. High street stores had the advantage over retail parks of not requiring planning consent for the sale of food.

28. TJ Morris said that the main barriers to entry for a discount retailer were ensuring sufficient supporting infrastructure was in place, and carrying out staff recruitment and training. [✄]

29. TJ Morris said that the time taken to open a new store was dependent on the retailer in question and how much refurbishment work it carried out on a store. For TJ Morris it typically [✄] to open a store after acquisition, although it had

taken [✂] to convert former Woolworths outlets. The total investment in a new store [✂].

30. TJ Morris did not have any specific requirements in terms of local population in order to consider a site to be viable. There were large variations both between different high streets and within the same high street in terms of busyness. This could also change over time, eg if a bus station or post office closed. It would look at the specific location within a high street to informally gauge its busyness when deciding whether to open a store there.

31. TJ Morris thought that it would be more difficult now than in the past to enter the VGM retail sector. It felt that there was now a critical mass required in order to compete with the large number of discount retailers, a number of which now supplied goods to smaller convenience shops. It cited the example of the £150 million spent on its warehouse in the South of England to demonstrate the high cost associated with running a very efficient operation and thus be competitive on price. Unless a retailer had 100 stores it would find it very difficult to buy the volumes necessary to get viable prices, set up the required infrastructure, including IT systems, and obtain economies of scale.

32. TJ Morris thought that the only new entrants likely to succeed were companies such as Aldi, which were well established in another country and able to withstand losses for five to ten years after entering the UK. It also noted that Aldi and Lidl had benefited from free publicity from the press during the recession of the 1980s.

33. It was very unlikely that it would respond to a small discount retailer operating in the same local area as one of its stores by lowering prices. [✂]. Although a small discount retailer might be able to sell products cheaply it would find it difficult to make a profit and reach a critical mass.

34. [✂]