J SAINSBURY PLC/ASDA GROUP LIMITED MERGER INQUIRY

SUMMARY OF HEARING WITH C, D AND E

Summary of hearing with Supplier C held on 31 October 2018

Negotiation process

1. Supplier C noted that, after the proposed merger, even the largest suppliers will represent a very small part of Sainsbury's and Asda's combined business. From a negotiation point of view, Supplier C said that the merged entity will continue to have a very strong bargaining power towards suppliers, which will be reinforced.

2. Supplier C explained that they have a limited amount of resources for customer investment and promotions and that they talk to their customers about how they can use this within their customer’s strategy to increase the volumes which customers sell to shoppers. Supplier C explained that they make these investments and support for promotional pricing in retailers to drive awareness of their products and to drive volumes with the aim that shoppers will purchase their products instead of their competitors’.

Harmonisation of supply prices across the merging parties / the merging parties' synergies analysis

3. Supplier C explained that the public statements of the merging parties indicate that claimed savings of GBP500MN will involve choosing the lower of the two prices currently charged by suppliers to either merging party and extending this across the merged entity.

4. Supplier C said that whilst it may make sense to equalise unit prices (ie the price prior to factoring in the effect of investment and promotional support behind an individual SKU) across the merged entity, it would not be possible to also equalise investment and promotional support across the merged entities, because Supplier C supports different SKUs with investments and promotional support at each of the merging parties.

5. Supplier C noted that supplier negotiations involve multiple stages and components and factoring in the effect of total investment and promotional spend across separate retailers who focus on different SKUs, in order to produce a fictional net price paid by the retailer, is not possible because each retailer focuses on promoting and investing efforts behind different SKUs. Supplier C explained that promotional and investment support is agreed with each retailer separately based on the willingness and motivation of the retailer to dedicate its attention to promoting individual SKUs or category of products. In summary, the investment and promotional spend varies depending on the category, the SKU in question, circumstances of the promotional event, the role that the supplier and retailer play in that event and the energy the retailer is willing to put behind a category or SKU. Supplier C noted that to 'harmonise' the so-called net price that each retailer pays for an item, after taking into account any promotional and investment spend does not make sense because each retailer chooses to focus on the promotion of different categories or SKUs. It would not be possible to equalise promotional and investment spend without a commitment of the retailer to put in the same efforts to drive volumes for each SKU in question for which "harmonised" investment and promotional spend is being sought.

Effect of charging lower prices to one retailer, on prices charged to other retailers

6. Supplier C said that it would be very difficult to charge higher unit prices to other retailers, in the event that the merging parties were able to extract lower prices post-merger. Supplier C confirmed that they had not seen any such effect following past mergers, such as Tesco/Booker or Coop/Nisa.

7. Supplier C said that, if they would have to make non-legitimate concessions to the merging parties (i.e. concessions which are not connected with genuine efficiency savings or commitment to provide correct consideration in return for increased investment and promotional spend), they may have to consider recouping this by reducing overall investment and promotional spend across the industry. Supplier C might also need to reconsider the amount of investment dedicated to innovation and research and development of new products. Supplier C noted that this did not happen with previous mergers, such as Tesco/Booker or Coop/Nisa.

Impact of the merger on innovation and new product development (NPD)

8. Supplier C explained that the cost of innovation is high, and this is one of the reasons why typically brands are slightly more expensive than own label

products which, essentially, copy the innovations that the brands have brought into the markets without incurring in any of the innovation costs.

9. Supplier C said that the proposed merger could lead to a profit shortfall if they had to make non-legitimate concessions to the merging parties and that they may have to recoup these losses through different means, including a reduction in innovation and NPD.

Impact of merger on listing of products / range / consumer choice

10. Supplier C explained that if the merging parties demand significantly lower cost prices or additional investments with no consideration in return (such as agreeing to promote increased volumes or to otherwise support and grow the SKU or category), in case of a refusal by Supplier C, this could lead to delisting of products. In other words, if Supplier C objects to making additional payments/investments to the merged entity where the merged entity does not commit to any consideration in return, then the result of such disagreement would likely be delisting. Supplier C said that this is a real threat to suppliers. Supplier C said that retailers are able to threaten delistings to achieve maximum impact on the supplier, and minimum harm to retailers. By way of example, Supplier C indicated that retailers target products where there are possible substitutes in the market and retain products which do not have a clear alternative such as another brand or a private label version. Supplier C concluded that delistings have a negative impact on customer choice.

11. To attempt to achieve the synergy figures that the merging parties have estimated, Supplier C indicated that, in addition to demanding extra payments from suppliers without any consideration in return, they expected the merging parties to rationalise ranges across the two retailers' estates and this would also lead to a reduction in customer choice. According to Supplier C, this would exaggerate a consolidating trend which many retailers are already following, as it is cheaper for them to service a more limited range.

Impact of achieving buying synergies in longer term

12. Supplier C noted that if the proposed merger happens, the long-term implications will be overwhelmingly bad for the consumers, as there will be fewer outlets and less choice of SKUs in the remaining outlets. Supplier C indicated that there is no indication that consumer prices will be any lower because less competition between retailers (via the reduction of the number of retailers) tends to lead to higher prices.

Summary of hearing with Supplier D held on 12 November 2018

Negotiations process

1. Supplier D said that in the last 3 to 4 years, levels of negotiations had become less frequent, and that they have a broader series of longer-term arrangements with the retailers. Supplier D explained that for winning products, or particular product categories, there is usually a tender process, with contracts that usually last between three to five years. Supplier D said that, once negotiation on price is agreed, they usually have a series of transparency models which allow them to manage both inflation and deflation. Supplier D noted that there are some differences in negotiation with each retailer, but that broadly they are moving towards a similar model of long-term arrangements. Supplier D said that negotiation would also be dependent on the product categories, as no two categories are the same.

2. As regards the main elements of the tender process, Supplier D explained that price and commerciality are significant, but technicality and quality were equally important. Supplier D noted that they have to be able to reconcile product specifications, so that they can procure the relevant items on a secure and solid supply chain to ensure traceability of ingredients. Supplier D said that they also have to illustrate that they can manage product categories and develop them for the retailer, whilst being able to grow it either in line with or ahead of the market. Supplier D noted that it is rare that any of negotiations are specifically related to price.

3. Supplier D said that they supply similar products to both Sainsbury's and Asda but with different specifications and additionally supply certain products to one retailer but not the other retailer.

4. Regarding transparency models, Supplier D said that certain retailers liked to use them, and others did not; for those who do not use them, it is purely a negotiation. Supplier D noted that having the transparency models allows them to have an independent review of price movement, although this is dependant on how the retailers decide to operate in some categories.

5. Supplier D noted that transparency agreements happen on a product-by-product basis, and different ingredients would be picked depending on the individual product. Supplier D states that they do not have transparency agreements for all ingredients, but only on those core ingredients where they prefer to have a more mature and balanced

engagement around price to avoid regular negotiations on price given that input costs change on a daily basis.

Harmonisation and Efficiencies

6. Supplier D said that Sainsbury's and Asda served different consumers, with different consumer profiles, and therefore had different product specifications, and Supplier D priced the product according to the specification. Supplier D noted that if Sainsbury's and Asda decided to move to one specification (as a result of the merger) then that would lead to a separate negotiation that they would enter into accordingly.

7. Supplier D said that it is very difficult to compare the variability in price of their product prices to Sainsbury's and Asda given that currently they both have different specifications and different products.

8. Supplier D said that they do not consider there will be any material manufacturing efficiencies to be made if the merging parties would align their product specifications and, thus, combine their volumes, but that this would depend on what Sainsbury's and Asda's plans are for individual specifications and whether they keep them the same.

9. Supplier D said that they do not envisage any material changes in their relationship with Sainsbury's and Asda if the merger is permitted, as they also trade with Tesco (which has a similar combined market share as the merged entity) in broadly the same way as they do with any other retailer.

10. Supplier D noted that there are some differences in the level of profitability that they secure from different customers, as it depends on a number of variables such as volume, the categories in which they trade, or they profit the particularly make in certain categories. Supplier D noted that the level of profitability they get from Sainsbury's and Asda is different.

11. In terms of innovation, Supplier D noted that the initiative to drive innovation in their lines is usually done jointly with the customer (but Supplier D may be slightly more proactive), when Supplier D is the only supplier in the category. Where a product category is shared with other suppliers, Supplier D said that the initiative is driven slightly more by the retailer.

Merger effect

12. Supplier D believed that innovation would not be stifled by the proposed merger. According to Supplier D, the market would still have a variety of

different customers, who would still need to innovate, and would arguably need to innovate even more, to maintain their market share position.

13. Supplier D noted that if the proposed merger happens, and the merging parties look to harmonise the best terms available, Supplier D will not try to recover that profitability through other customers as it would be very difficult to justify an increase on prices, in particular, given that in many cases they operate with transparency models.

14. Supplier D said that Sainsbury's and Asda are very different retailers and their product specifications are also different. They have a slightly different attitude towards price, which has a knock-on effect regarding range and range architecture. In terms of opportunities, Supplier D said that the merger provided both risk and opportunity in equal measure, and it did not see the merger as a real concern.

Summary of hearing with Supplier E held on 12 November 2018

Negotiation process

1. Supplier E stated that they do not have a list price policy but that, instead, they set a target margin for their sales team to get as good a deal as they can through negotiations with different retailers on a case by case basis.

2. Supplier E stated there are different levers in the negotiation process. Supplier E explained that they have the target base margin (which is the cost price that goes to the retailer) and the promotional strategy (which is centralised and negotiated with retailers and relates to the number of promotions they are going to do with that particular retailer) which are fixed elements during negotiations and will be the same for every single retailer. Supplier E explained that there are other elements such as the gate fee (which refers to how much Supplier E will be required to pay by each retailer to fund in store displays) or fixed fees, and that these aspects differ between retailers and are usually subject to negotiation.

3. Supplier E stated that their target margin is the same for all negotiations with retailers, regardless of their size. Supplier E stated that they have a 'walkway position' meaning that, based on the outcome of a negotiation with a grocery retailer, they would make a business decision to walk away if they cannot get a deal done (ie if they cannot reach their target margin).

4. Supplier E said that the difference in logistical costs associated with serving smaller retailers is not built into their target margin, as it is a separate consideration they would overlay. Supplier E stated that they outsource the more complex supply chains to third-party distributors and the differences in the supply chain results in differences in the costs to serve their products.

5. Supplier E noted that grocery retailers try to renegotiate commercial terms every year with the aim of getting more resources from them. Supplier E said that they look to get counterparts in return during these negotiations to make their business viable.

6. Supplier E stated that they have built a very collaborative relationship with Sainsbury's within the last few years. Supplier E stated that their relationship with Asda is the opposite.

7. Supplier E said that they have never been able to use innovation to change cost prices of exiting products, as grocery retailers would not accept this.

Supplier E stated that a cost price increase would happen if they were looking to recover costs for existing products, for example, from creating a new package or an increase in input costs. Supplier E said that they would try to pass, at least part, of the costs on to the retailers, but that this may imply retaliatory measures from the retailers against their business in the short term. However, Supplier E stated that they will accept this when these cost price increases are necessary to ensure the future profitability and viability of their business.

Harmonisation

8. Supplier E stated that discussions with grocery retailers around joint business plans take place across a portfolio rather than on a product by product basis.

9. Supplier E stated that they would attempt to resist any 'cherry-picking' of the most favourable cost prices of each of the merging parties, as cost prices are not normally the focus of negotiations. Supplier E said that they anticipate that the merging parties would seek to leverage their new found size and associated increase in buyer power to dictate more favourable terms related to promotions or the cost of administration. Supplier E noted that these costs become the focus of negotiations instead of cost price.

10. In terms of the negotiating process of harmonisation terms, Supplier E stated that their concerns are not primarily cost prices but the commercial terms around negotiations and the agreements made. Supplier E explained that attempts by the merged entity to cherry pick the optimum combination of cost prices and promotional payments would risk Supplier E paying twice for listing fees, point-of-sale support, marketing support and promotional support. Supplier E noted that this would potentially lead to substantial overinvestment without receiving the same growth and product development opportunities.

11. Supplier E stated that, in previous cases, the scenario was similar. Supplier E stated that they are concerned that this may happen with the merger between Sainsbury's and Asda, by which Sainsbury's may look to draw the stock in themselves and redistribute it to Asda, with Asda taking Sainsbury's cost price without having to negotiate for these investments or to provide the support anticipated when the terms were agreed.

Innovation

Lifecycle of new product development – how products are brought into UK market

12. Supplier E stated that, to bring new products to the UK market, they undertake a process where they review trends in the market and make

decisions on which markets to invest and launch their products in. Supplier E explained that they will start with many ideas, but that they tend to funnel them down to one or two each year due to the high costs.

13. Supplier E noted that they try to introduce a new product per year. However, there has only been one successful product launched within the last 8 years.

Impact of the proposed merger on investment

14. Supplier E stated that the proposed merger along with the ongoing global consolidation of retailers puts a lot of pressure on innovation and on their business profitability. Supplier E explained that passing on increased cost prices to retailers to recover the levels of investment required by the merged entity are not simple nor an easy process, in particular if they do not have a justification. For these reasons, Supplier E noted that they do not think the merger would lead to increased cost prices to smaller retailers, but it would affect the investment levels. Supplier E said that the merger may lead to Supplier E being able to afford lower levels of investment in other retailers, given the significant leverage of the merged entity and Supplier E's limited resources, compared to the pre-merger position.

15. Supplier E noted that suppliers have to concentrate on their core business and reduce spend on innovation in order to survive in the market as their margins have been getting lower over the last few years. Supplier E said that although investment is important for the business in the long run, the high costs and margin reduction sometimes do not justify the investment. By way of example, Supplier E said they have pulled about ten innovation projects this year because of costs of launching.

Efficiencies

16. Supplier E stated that they do not envisage any manufacturing or logistical efficiencies as a result of the proposed merger, as the merging parties are going to keep their businesses separated. Supplier E noted that the proposed merger may potentially bring savings from reduced administration and having to deal with potentially one set of buying teams or invoices.

Merger effects

17. Supplier E said that they are more concerned about the consolidation going on globally rather than the proposed Sainsbury's Asda merger in isolation. According to Supplier E, manufacturers are suffering some pressure due to this consolidation.