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15 October 2010

ATTENTION: MR DAVID JONES

Mr David Jones
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

By email to: mergers@accc.gov.au

Dear Mr Jones,

I attach NARGA's response to the ACCC's *Statement of Issues* in relation to the proposed Metcash acquisition of Franklins.

Please contact me if you require any further information.

Yours sincerely,

Ken Henrick
Chief Executive Officer

S U B M I S S I O N

to the

AUSTRALIAN COMPETITION

and

CONSUMER COMMISSION

Response to the *Statement of Issues -*

Metcash Trading Limited - proposed

acquisition of Franklins supermarket business

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Introduction

While independent grocery retailers in New South Wales stand to benefit from increased buying power if the existing 88 Franklins-branded stores join independent ranks, it should be clearly understood that for most independent grocers in Australia the acquisition is irrelevant.

We shall deal with the *Issues Paper* in detail later in this document, but the following information contains important context and background for the matters raised.

For example, the *Issues Paper* contradicts, in parts at least, the *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*[1] and restates some of the errors contained therein.

The key issues which illustrate the ACCC's flawed analysis are:

- Misuse of the word "wholesaling" to describe Franklins' third party contracted warehousing for a total of only seven franchised stores and one independently-owned store. The ACCC now describes this as Franklins' "wholesaling" business.
- Two years ago the ACCC's grocery inquiry report didn't regard Franklins as a wholesaler. Now the ACCC regards Franklins eight store "wholesaling" business as so significant that there would be a substantial lessening of competition if it were to be acquired by Metcash
- The continued misrepresentation of industry structure, based on the assumption that "vertically integrated" chains are inherently more efficient than the independent sector - but no evidence is brought forward to support the contention. Indeed, the ACCC regards the "wholesale" operations of a vertically integrated retailer as cost-free
- The *Issues Paper* fails to acknowledge that competitive benefits would flow to independent retailers and their customers in NSW - where independents' market share is weakest - if the Metcash acquisition of the Franklins stores were to be approved.

The *Issues Paper* differentiates between "vertically integrated retailers" - Aldi Woolworths, Coles and the Franklins corporate stores - and independent retailers such as IGA stores supplied by the major wholesaler, Metcash. The UK Competition Commission observed in its report on its 2007-08 grocery market investigation that Aldi stores were not direct competitors of full service supermarkets, but should be regarded more correctly as "limited assortment discount stores".[2] As such, Aldi and other LADS were excluded from consideration by the UKCC. The ACCC has chosen to regard Aldi as a major player in the Australian grocery industry, yet Aldi has less than four per cent of the national retail grocery market (and Franklins only 1.4 per cent).[3]

[1] *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries,* ACCC, July 2008
[2] *The supply of groceries in the UK: market investigation,* UK Competition Commission, 30 April 2008, p8, paragraph 14
[3] Company reports 2009, Euromonitor and other publications.

The *Issues Paper* indicates that the ACCC is not as familiar with the operations of the Australian grocery industry as it might and perhaps should be. This leads to the generation of false propositions and assumptions. For example, the *Issues Paper* at Paragraph 91 says:

> *91. The ACCC found in the Grocery Inquiry that Metcash appears to set its wholesale prices to independent retailers under the retail pricing 'umbrellas' set by Coles and Woolworths. This wholesale pricing was found to limit the ability of independent retailers to aggressively pursue market share from Coles and Woolworths through price discounting.*

This betrays the fact that, more than two years after the grocery inquiry, the ACCC still does not understand that price discounting - the offering of "specials" - in the grocery industry *around the western world* is initiated by suppliers, not retailers.

ACCC's core proposition

The commission's core proposition is that there would be a substantial lessening of competition if the Franklins "wholesaling" business were to be acquired by Metcash.

Paragraph 37 of the *Issues Paper says:*

> *37. The ACCC notes there is a key difference between Metcash and Franklins in terms of their wholesale supply to independent retailers. To date, with very limited exceptions, Franklins has chosen to provide wholesaling services to the Franklins franchisees only (and the corporately owned Franklins stores), whereas Metcash supplies both IGA and non-IGA branded retailers.*

One could take the view that no "choice" was involved, since Franklins has been able to attract only one store to switch from Metcash to a Franklins' supply agreement. The ACCC does not substantiate its claim at Paragraph 35 that *"independent retailers can and have switched between Metcash and Franklins for supply of grocery items and marketing and brand support services."* Only one has done so, to our knowledge.

However, the commission misrepresents the meaning of *wholesaling*. According to the *Oxford Concise Dictionary*, "wholesale" means *the selling of things in large quantities to be retailed by others.*[4]

Most significantly, at paragraph 7.2.3 of its 2008 grocery inquiry report, the ACCC listed the grocery wholesalers operating in Australia at that time. Franklins was not among them, yet they had been franchising since 2005.[5]

In 2008, the ACCC expressed the following view[6]:

[4] *Oxford Concise Dictionary*, The Clarendon Press, Oxford, eighth edition, 1990
[5] op. cit., p. 131
[6] Ibid., p. 156

The ACCC acknowledges Metcash's argument that independent retailers may be able to access 'an alternative supply chain with Franklins', and while considering this may be true in certain circumstances in New South Wales, the ACCC also considers that the required rebranding of stores to Franklins is likely to act as a deterrent for many existing independent retailers.

Of the 88 stores supplied by Franklins, 80 are Franklins' corporate stores. The other eight stores, were they to be supplied by Metcash, could not in any rational, logical or objective sense represent a substantial lessening of competition within the NSW market (*Issues Paper,* Paragraph 69). Only one of the 88 Franklins stores, to our knowledge, would, if acquired, compete in the same local market as an existing IGA store, although two independently-owned IGA stores in the same local market would still be in competition on service, convenience, range and would be free to set their own prices outside banner specials. Such a situation would not be the same as having two Woolworths stores in the same market, or Coles and Bi-Lo stores in the same shopping centre, as has occurred in at least two places we know.

In any case, Pick n Pay, has now announced it will quit the Australian market, regardless of any decision by the commission.[7] This would appear to confirm *Counterfactual 3*; however, any stores bought by independents outside the proposed acquisition by Metcash would still need to be supplied by Metcash.

Counterfactual 1 has now been eliminated; *counterfactual 2* would depend on whether the hypothetical "alternative single buyer" were prepared to pay a price higher than that offered by Metcash or at least acceptable to Pick n Pay, an option which is highly unlikely. Despite the ACCC's claim that it has *"received information supporting the view that there are other parties who would wish to acquire the wholesale and retail business or alternatively the retail stores if given the opportunity",* to our knowledge no other bid has been put forward.

Consolidation of grocery wholesaling businesses

It is worth observing that at the beginning of the 1990s, when Woolworths and Coles had a combined market share of only about 50 per cent of national packaged grocery sales, there was an independent grocery wholesaling business in each state - Davids Pty Ltd (NSW), Composite Buyers Ltd (Victoria), Queensland Independent Wholesalers Ltd, Independent Holdings Ltd (South Australia), Foodland Associated Limited (Western Australia) and Tasmanian Independent Wholesalers.

These businesses were under pressure because of Woolworths' and Coles's aggressive creeping acquisitions, their other site acquisitions and store redevelopments and rapidly growing market share.

Over several years, Davids, with the approval of the ACCC and the Australian Competition Tribunal, acquired most of these wholesaling businesses (plus the Jewel Food Stores business which was Davids's major customer). Tasmanian Independent Wholesalers and Foodland Associated Limited continued to operate. The Davids wholesale business was itself later

[7] Pick n Pay board announcement, Cape Town, South Africa, 11 October 2010, attached.

acquired by Metcash Trading Limited. Metcash Trading Limited, again with the approval of the ACCC, acquired Foodland Associated Limited's Australian wholesaling business in 2005, with Woolworths at the same time acquiring FAL's New Zealand business, plus 19 Action stores and three Action development sites in Australia.

Consolidation of the independent wholesaling and retailing sectors was seen as the best, perhaps only, defence against the chains' rapid expansion. Smaller wholesalers operating within single states lacked market power *vis a vis* the major chains and were vulnerable to losing their biggest and best customers to the chains' creeping acquisitions programs.

Until the 1990s, Cannons supermarkets in the Australian Capital Territory and southern New South Wales were supplied by the company's own wholesaling business, which also supplied independent grocery stores in various locations in southern New South Wales. The ACCC approved Woolworths acquisition of the entire Cannons business in 1996. Woolworths subsequently shut down the Cannons warehouse and wholesaling operation. The Cannons acquisition gave Woolworths retail monopolies in Cooma and Batemans Bay at the time, situations which we regarded as clear instances of substantial lessening of competition.

Finally, Woolworths also opened its own grocery wholesaling business, Australian Independent Wholesalers Pty Ltd, during the 1990s, supplying a number of independent stores, including those under the FoodWorks banner, but failed to be price competitive with Metcash as a wholesaler and later closed down the business.

The failure of wholesaler competitors of Metcash is strong evidence to confirm the proposition put by NARGA during the grocery inquiry that the independents' share of the grocery retailing market in Australia is not large enough to support a second viable wholesaler capable of supplying a full range of packaged grocery products. Indeed, the ACCC acknowledged this in its grocery inquiry report.[8] Further, the ACCC acknowledged that competition from the dominant major supermarket chains put competitive pressure on the wholesale prices charged by Metcash and the retail prices which major independent supermarkets could charge their customers.[9] The focus of the *Issues Paper* on wholesale pricing matters is therefore curious but irrelevant.

Indeed, although the cost of entering the wholesaling market is relatively low, as Franklins demonstrated, the ability of a small wholesaler to deliver a large range of price-competitive goods is limited by economies of scale, as the disappearance of wholesalers from state markets (and the consolidation of the wholesale market, first by Davids, then by Metcash) demonstrated.

The Franklins "wholesale" business operations under Pick n Pay have been geographically limited to New South Wales, inconsequential to retail competition in that state, irrelevant to grocery wholesaling and retailing markets in other states and, as a result, have proven unsustainable.

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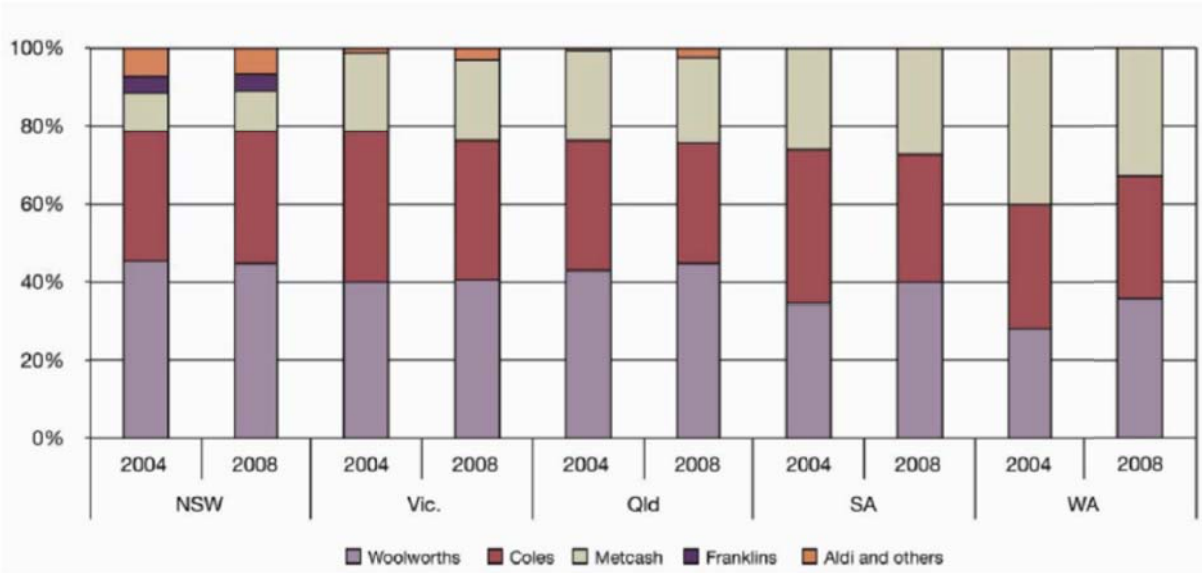
[8] op cit, p. 127, 159
[9] op. cit., p. 154

NSW is an exception. NSW and Queensland in recent years have had two grocery wholesalers. Yet the independent retailing sectors in other states have acquired greater market share than independents in New South Wales, as the ACCC reported in 2008[10]:

Chart 3.3 Nielsen: retailers' shares of packaged grocery sales (by state)



Note: 'ALDI and other' is a projection (i.e. it is not based on point-of-sale scanning data).
Source: the Nielsen Company

This would seem to disprove the ACCC's proposition that a second wholesaler would bring competitive benefits to independent retailers and their customers in NSW.

The return of the Franklins stores to the independent sector would merely restore some of the market share lost to the chains through creeping acquisitions.

Pointless theorising and wishful thinking about the potential for the Franklins business to thrive and grow and to provide wholesale competition to Metcash is contradicted by the reality of Franklins' failure in the Australian market.

According to the Pick n Pay board statement quoted earlier, Franklins has not achieved an acceptable return on investment in the Australian market. As noted above, Franklins has not been a genuine wholesaler. It has operated two distribution centres on contract and has "chosen" not to market itself seriously as a wholesaler to third party customers *because it has not been* a genuine wholesaler.

Franklins' difficulties in the Australian market and the option to " actually sell our business and move back to South Africa" have been in the public domain since the 2008 grocery pricing inquiry[11] and were publicly aired again by Pick n Pay in May 2010.[12]

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[10] Ibid., p. 50
[11] op. cit., p. 144
[12] "At the checkout", *Financial Mail*, 13 May 2010 www.fm.co.za/Article.aspx?id=108872

It should also be noted that Pick 'n Pay has previously entered and exited, the Australian grocery retailing market. It operated two hyper-markets in Brisbane during the 1990s, but, as now with Franklins, lacked the market bulk to be viable and sold the stores to Coles.

The situation which will obtain after Pick n Pay exits the Australian grocery market will be as it was before they acquired the Franklins stores from Dairy Farm International. However, if Metcash acquires the Franklins stores, the independents' position in NSW, where they have been relatively weak for many years, will be significantly improved by having a larger co-operative marketing and advertising budget and access to improved terms from suppliers.

Responses to *Issues Paper*

The Australian Competition and Consumer Commission has overseen the consolidation of the Australian wholesale and retail grocery industry to the point where the retail sector is now the most concentrated in the world, with two major supermarket chains, Woolworths and Coles, jointly holding just under 80 per cent of the market.[13]

In its grocery inquiry report, the ACCC put the figure at 70 per cent[14], but without any explanation of how that figure was settled upon.

Retailing models

The ACCC has for many years used flawed models of how the grocery industry works. We have drawn this to the commission's attention on several occasions.

The *Issues Paper* expresses the same misunderstandings.

It raises the issue of whether there are inherent additional costs in a supply chain which includes a major wholesaler, Metcash, when compared to the "vertically integrated" grocery retailers, Aldi, Coles, Woolworths, and the company-owned and operated Franklins stores, but not their franchised stores, [*Issues Paper, Table 1]*.

If the ACCC's theories in relation to the vertically integrated retail model were correct, the commission should be able to demonstrate that Franklins extracted no "wholesale" profit in supplying its corporate stores, but did extract a profit from its franchised stores and the sole independent retailer customer. These eight stores would thus have retail prices different from (and higher than) those of the Franklins corporate stores.

The fundamental error which the ACCC has repeatedly put is that there is no wholesaling cost or profit margin borne by vertically integrated retailers and that there is an "additional" cost and profit margin in the independents' supply chain.

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[13] *The economic contribution of small to medium-sized grocery retailers to the Australian economy, with a particular focus on Western Australia,* PricewaterhouseCoopers, Sydney, June 2007, p. iv; *Retailing in Australia 2009,* Euromonitor.

[14] op. cit., p. 51

In contrast to the ACCC's view, it is standard operational practice in any company in any industry sector to recover costs plus an operating profit from any cost centre.

The ACCC confirmed in its 2008 grocery pricing report that it sees the "vertically integrated" chains as being a lower cost supply chain than that of the independent sector. Specifically, the ACCC grocery pricing report said[15]:

> *"...the ACCC considers that the prices Metcash sets for its wholesale packaged groceries are a significant factor holding many independent retailers back from more aggressive price competition...Metcash is the only significant wholesaler to independent supermarkets in Australia. Metcash sets its wholesale prices for packaged groceries in such a way that independent retailers can only compete with Coles and Woolworths on price by earning low net margins on the goods supplied by Metcash. Evidence suggests that those independent retailers that attempt to compete on price make their profits on fresh products and individual items sourced directly from suppliers."*

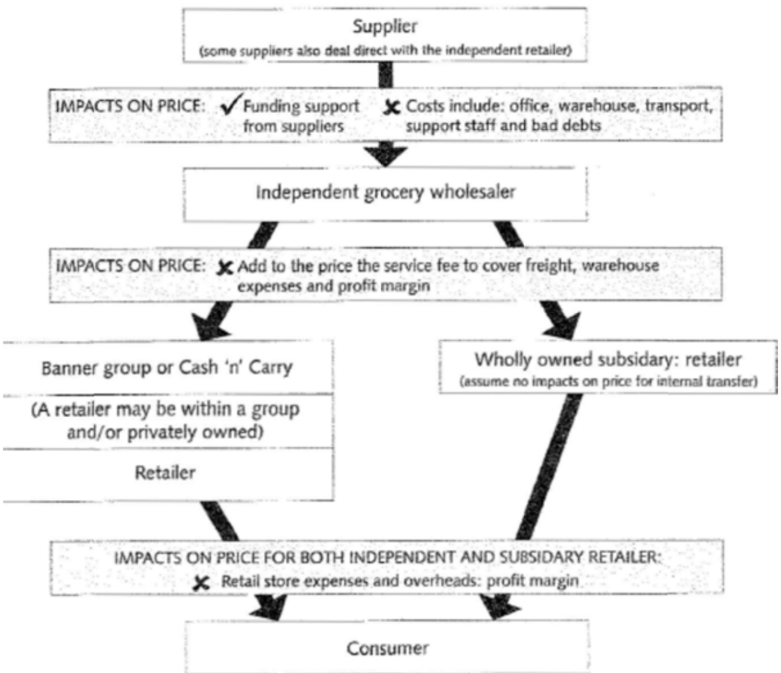
The diagram on the following page.[16] has been used by the ACCC in various submissions and publications over a number of years. Note the absence of cost attributed to the chains' wholesaling activities

[15] op. cit., p. xvii

[16] *Report to the Senate by the Australian Competition and Consumer Commission on prices paid to suppliers by retailers in the Australian grocery industry, September 2002, p. 16.*

Supermarket (major retail) chains

Independent grocery sector



The evidence referred to was given to the grocery inquiry in part by NARGA. We did not argue that profits were possible on branded, packaged products supplied direct to retailers but not on those supplied via a Metcash warehouse. We DID make the point that the chains ALSO barely cover costs on branded, packaged grocery products and make their profits from fresh food departments. That is how the industry works. That was not accurately reported by the ACCC.

To suggest that Woolworths, Coles, Aldi and Franklins wholesaling businesses operate cost-free and without making a trading profit is incorrect. These businesses are not charitable organisations. They represent multi-million dollar investments of capital and recurrent expenditure and require a return on investment if they are to remain profitable for shareholders.

According to the ACCC's grocery pricing report, Franklins' turnover at that time was $812 million from 80 corporate stores.[17] Franklins' then Managing Director, Mr Aubrey Zelinski said in evidence that he thought the company had improved its terms of trade after ceasing supply by Metcash.

> *"I think that for us the relationship of dealing with suppliers has given us an advantage in terms and so the rebates that are passed on to owning your own warehouse adequately cover the cost of the warehouse for use."*[18]

Our emphasis. Clearly, Mr Zelinski indicates that the "wholesale" function of a vertically integrated retailers entails a substantial cost. The ACCC has chosen not to acknowledge that fact. However, we can see no reason why a company with a turnover of $812 million could "improve" its terms of trade with suppliers compared with the prices Metcash could achieve for Franklins from much greater volumes.

According to the ACCC's theories, vertically integrated retailers have no "wholesale" costs at all. What is more, the ACCC grocery inquiry report made the following claim, showing little or no understanding of commercial reality[19]:

> *The ACCC considers that competition with the MSCs does constrain Metcash…However, the constraint of retail competition on Metcash's wholesale pricing is not as strong a constraint as it would be on a vertically integrated company equivalent to the Metcash-IGA network. A vertically integrated grocery retailer will ultimately absorb the entire downside to increased wholesale prices. In contrast, Metcash as a non-vertically integrated wholesaler has a certain ability to pass on some of the impact of increased wholesale prices to independent stores that may be willing to accept lower margins. This arguably gives Metcash a certain 'cushion' from the full effects of retail competition.*

Again, our emphasis. To believe for one moment that Woolworths or Coles or any other 'vertically integrated' company absorbs cost increases from suppliers reveals no understanding of commerce or the Australian grocery industry. Nor does it acknowledge the duopsonistic market power of Woolworths and Coles, with their 80 per cent combined market share. Woolworths and Coles are price setters, not price takers.

In Tasmania, Woolworths and Tasmanian Independent Retailers operate a joint venture wholesale business, Statewide Independent Wholesalers Ltd.

The cost to supply goods to a Woolworths supermarket in Tasmania is the same as it is for an independent retailer. The operational cost of the warehouse is shared by Woolworths and TIR in proportion to their market share. Similarly, profits made by the Statewide Independent Wholesalers warehouse are shared in the same proportion. It is not a zero cost wholesale business. Nor are any of the vertically integrated chains' wholesaling businesses cost free.

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[17] Op. cit., p. 143
[18] Ibid.
[19] Ibid., p. 154

Regardless of how Woolworths, Coles, Aldi or Franklins operate their wholesaling businesses, the same or similar costs will be incurred in delivering stock to the loading docks of their stores. Delivering goods to the loading docks of independent supermarkets entails the same range of costs.

The ACCC's understanding of how the supply chain works is seriously flawed.

As is evident from the ACCC diagram reproduced above, the claim that a vertically integrated supply chain is more cost effective can be correct only if one attributes - falsely - no cost to the major supermarket chains' wholesaling operations. As we have now shown, that is not the case.

Significantly greater unilateral market power?

The ACCC's "issues of concern" (Paragraph 70) claim that as a result of the proposed acquisition of Franklins, Metcash *"is likely to have significantly greater unilateral market power".*

However, the grocery pricing report acknowledged that Metcash's prices are constrained[20]:

> *"Although Metcash is the only significant wholesaler to independent retailers, there are two significant threats that constrain Metcash's pricing behaviour. First, independent stores can either individually or collectively establish their own wholesaling operations for packaged groceries, as Franklins has done. Secondly, there is the threat of the independent supermarkets losing sales to Coles and Woolworths. Both these factors are constraints on Metcash's pricing to independent supermarkets. However, they are limited constraints."*

The constraints implicit in competition with the major chains are absolutely critical, not limited. The claim that an individual independent retailer might be able to establish a wholesaling business is refuted by the fact that major suppliers either refuse to supply an independent retailer directly or will do so only with a prohibitive surcharge (see comments on *Issues Paper* Paragraphs 31-33 below). The claim that Franklins had done so (with the implication that this had been successful) has been refuted by the failure of both the Franklins wholesale and retail businesses. Metcash supplied independents, on the other hand, continue to compete with the chains on price, again contradicting the ACCC's conclusions.

Metcash already operates without significant wholesale competition in Queensland, New South Wales, Victoria, South Australia, Western Australia, the Australian Capital Territory and the Northern Territory. However, the constraints arising from retail competition with the major chains are substantial.

Perceptions of retailer formats

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[20] ibid.

Paragraphs 19 and 20 of the *Issues Paper* raise the question of public perception of different retailers and their store formats.

It is true that in the largest group of grocery retailers in Australia - the independently-owned stores - there is a wide variety of formats. However, they can be distributed into three groups: small, medium and large. The UK Competition Commission's work in relation to its report on its grocery market investigation elaborates the competitive relationships between retailers of different sizes.[21] It makes the point that smaller stores do not exert competitive pressure on larger stores, but larger stores do exert competitive pressure on smaller stores. The only valid comparison of retailer competitive pressure, then is to compare stores of equivalent size.

In the past, the ACCC has attempted to lump all independent retailers into the same basket and in doing so may well have adversely affected public perception of the independent retailing sector. The pricing of products in the failed GroceryChoice operation springs readily to mind. In that exercise, the contractors appointed by the ACCC surveyed small independent stores' prices, ignoring the minimum floor space parameters.

Further, the prices of those small stores, medium independent stores and Supa IGA stores were "averaged" and represented by the ACCC's GroceryChoice reports as a single "IGA price" implying that independent stores as a whole were not price competitive with Woolworths or Coles.

The misrepresentation was exacerbated by the ACCC's claim that Aldi, with its only 500 mostly private label product lines in (then) only 200 stores in the three eastern mainland states were bringing a "competitive dynamic" to the entire Australian grocery retailing industry. The ACCC then concocted a "basics" basket to allow Aldi to be included in the GroceryChoice surveys (Aldi's 500 product line range would have precluded them from inclusion in the full survey). Oddly, the ACCC's 2008 grocery report said elsewhere that Franklins, rather than Aldi, had a significant impact on pricing in Coles supermarkets, but little effect on Woolworths.[22]

Yet the UK Competition Commission had excluded Aldi from their UK market investigation because they regarded Aldi as "limited assortment discount stores" and not genuine competitors of full-service supermarkets. At the same time, the ACCC excluded from comparison the prices charged by Woolworths and Coles in their own service station convenience stores, a more appropriate comparison with small independent stores' prices.

Yet, for all that, and despite the "competitive dynamic" allegedly initiated by Aldi, the grocery inquiry report found[23] that supermarket retailing was only "workably competitive" overall. The commission found that the

> *"...lack of incentives for Coles and Woolworths to compete strongly across the board on prices reflects the high levels of concentration in the industry...Evidence*

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[21] UK Competition Commission, grocery market investigation, *"Working paper on market definition", May 2007.*

[22] op. cit., pp 170-1

[23] op cit., p. xvi

indicates that if one player attempts to lead prices down, the other will follow, making it extremely difficult for either to win significant numbers of customers from the other through an aggressive pricing strategy...Australian consumers would significantly benefit if Coles and Woolworths faced more competitive threats that encouraged more aggressive pricing strategies."[24]

Part of the ACCC's theoretical remedy for this situation was the proposed introduction of a second wholesaler,[25] (though how fragmenting the wholesale sector would force the chains to compete on price, even in theory, was never explained - the two majors would still have nearly 80 per cent of the market while the wholesalers and independents, according to the ACCC's theory, would compete amongst themselves by lowering their prices and reducing their own profitability and viability).

The ACCC *Issues Paper* further postulates that Franklins' "wholesale" business is a "real competitive 'threat' to Metcash in NSW" [Paragraph 74], although Franklins' problems with viability have been in the public domain since at least the 2008 grocery inquiry.

Nevertheless, the *Issues Paper* now seeks to represent the Franklins wholesaling business, covering eight stores, as of such vigour and heft that its acquisition by Metcash would represent "a substantial lessening of competition in the market for the supply of packaged groceries to independent retailers in NSW" [*Issues Paper*, Paragraph 69, Paragraphs 72-78] despite the fact that no such "wholesaler" role was identified by the ACCC for Franklins during the grocery inquiry.

Indeed, if the ACCC's theoretical remedy, outlined above, were valid, then a higher level of price competition should already be evident in the NSW market because of the presence of Metcash and Franklins wholesale businesses. The ACCC *Issues Paper* puts forward no evidence that this is so and, in any case, the independent sector is stronger in other states.

Pick n Pay's decision to exit the Australian market suggests that a second substantial wholesaler capable of supplying a full service supermarket may not be viable in any Australian state market.

More than two years after the grocery price inquiry ended, the ACCC still has not adequately informed itself of the way the Australian grocery industry actually functions.

The strength of the independent sector is based on an aggressive promotional program through the Supa IGA and IGA format stores. That is co-ordinated through IGA Distribution and provides competitive tension in the national grocery market.

From a retailer's perspective, the support provided by Metcash through the IGA network is evident in many ways:

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[24] op. cit., p. xvi

[25] Ibid., p. xviii

- The volume of goods purchase don behalf of IGA stores by Metcash allows the independents to tap into the larger purchasing power of the wholesaler - which they would not have on their own or through smaller wholesalers or buying groups
- Metcash coordinates promotions (specials) and case deals which give the independents the ability to compete with the MSCs
- Part of that coordination activity involves the placement of television advertising, print advertising and the printing of flyers, posters and leaflets more cost effectively than is possible for individual stores or groups of stores to achieve
- Independent stores are organised through the UGA network, through state boards and through a national board to coordinate cooperative programs and provide feedback to the wholesaler. These programs include the funding of broadly-based advertising and promotional activities as well as lobbying and research, are agreed at board level and jointly funded via agreed levies.

Paragraph 26 of the *Issues Paper* refers to the operation of the Franklins wholesaling business. According to this paragraph, Franklins has two distribution centres with a combined total of about 18,000 product lines, which represent about 90 per cent of the range available to Franklins retail stores.

IGA Distribution ranges 29,000 product lines, excluding fresh food lines. These account for 50 to 60 per cent of the range in an average IGA independent store.

Clearly, Franklins customers are currently disadvantaged in terms of choice and product range. Clearly, acquisition of those stores by Metcash for on-selling to independent operators will result in customers of those stores having access to a greater range at cheaper prices (see response to Paragraphs 19 and 20, above).

Paragraphs 31, 32 and 33 of the *Issues Paper* deal with access to supply of grocery products.

Independent retailers generally cannot source major brands directly from suppliers. The suppliers have effectively forced independent retailers to source their purchases from a wholesaler's warehouse. As an example, Arnotts supply the three major wholesale acquirers. Arnotts also offers to supply independent retailers direct, but apply a surcharge which would make the shelf price of the product uncompetitive with the major chains if the same gross margin were to be applied at retail.

Economies of scale inherent in delivering relatively large volumes of product to the three major wholesale acquirers' warehouses have enabled suppliers to operate profitably. Delivering direct to store, as large suppliers like Arnotts used to do, is now regarded by them as uneconomical (thus the surcharge).

Recognising that this is an efficient and cost-effective way of supplying individual supermarkets, it should also be acknowledged that the result is better retail prices for consumers.

Wholesale supply options

Metcash acquired Foodland Associated Limited's Australian wholesale business and some retail stores in 2005, just as it is proposing to acquire the Franklins wholesale business and retail stores in 2010.

Independent retailers formerly supplied by FAL and now supplied by Metcash in Western Australia have suffered no disadvantage since that acquisition. Retailers continue to obtain products from the Metcash warehouse in a timely and efficient way and at a cost that enables them to compete on price on a daily basis with Coles and Woolworths. Progressive Supa IGA stores continue to be the lowest priced supermarkets in Western Australia.

Independent retailers in South Australia, including large groups such as Drake Foodmarkets and the Romeo Retail Group, continue to thrive.

It is fanciful to suggest that the presence of a second (or third, or fourth?) wholesaler would improve prices or efficiency in the supply chain or that independent retailers would be better served by direct deliveries by multiple suppliers.

Supply chain logistics are complex and difficult to manage, even for a large, specialised wholesaler. To imagine that an each independent retailer could co-ordinate deliveries by multiple suppliers to allow efficient night filling of shelves reflects a lack of understanding of both wholesale and retail logistics. The more suppliers which deliver to a store, the greater the congestion and the greater the potential for waste and inefficiency.

The cost of freight is best managed by aggregating pallets, particularly for delivery outside metropolitan areas: the cost to an individual retailer is amortised across all goods on many pallets.

Coca Cola is now routed through distribution centres to supermarkets. Previously the product was delivered by a Coca Cola distributor at a cost to the retailer of ten cents per two litre bottle. The cost is now three cents per two litre bottle[26] - the cost is the same or very similar to what it costs Woolworths and Coles to distribute to their stores.

Apart from the seven Franklins stores which have been franchised, only one IGA store changed from Metcash to Franklins for wholesale supply. Independent grocery retailers can be assumed to know what is in their own best interests, but the overall result is that of all independent grocery retailers in New South Wales, only an inconsequential number has chosen the alternative source of wholesale supply. In dollar terms and volume, these stores have no impact on the operation of the independent sector.

Areas of overlap - wholesale

Metcash's wholesale business can survive only if it supplies its independent retailer customers at prices which allow them to compete with Woolworths and Coles. Any retail business needs to ensure delivery of product in a timely and cost-efficient manner. This is especially important to the supply of weekly specials and promotional activity in the grocery sector. Independent retailers need to be able to access high profile products such as Coca Cola 2litres

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[26] These are actual costs from Merredin Supa IGA in Western Australia.

at the same promotional price that Coles and Woolworths offer - for example, at $1.99 when the shelf price is $3.29

The relationship between Metcash and its retailer customers is interdependent: if Metcash could not deliver product at prices which allow retailers to compete, both the retailer and Metcash would go out of business. There is little or no price elasticity in the prices Metcash can charge its customers.

Areas of overlap - retail

Franklins supermarkets are likely to become independently-operated IGA bannered stores post-acquisition.

According to the *Issues Paper,* "...the ACCC considers that there is potential overlap between individual IGA and Franklins retail supermarket stores within local retail areas." As noted earlier, of the Franklins bannered stores which may be acquired, only one is a direct local competitor of an existing IGA store.

As the ACCC has acknowledged elsewhere, grocery retailers compete to deliver value on price and quality, on convenience, range, product mix, service, loyalty programs, discounts and specials and community ties. [Paragraphs 18 and 19]

The fact that two independently owned stores in the same local market might carry the IGA banner does not preclude them from competing in any or all of these ways. An IGA store which competes with a Franklins store today will compete with a re-bannered store.

With/without test

The ACCC will by now be aware that Pick n Pay announced on 11 October 2010 that it intends to exit the Australian market and dispose of its Franklins business, regardless of whether the ACCC approves the proposed acquisition by Metcash.

The Pick n Pay announcement said in part:

> *Pick n Pay Chairman Gareth Ackerman commented: "Following the strategic review announced earlier this year, Pick n Pay took a decision to exit the Australian market... The decision to sell Franklins was not taken lightly. Without the benefits of scale in the market and in the face of unprecedented discounting by Woolworths and Coles, we consider it essential to start this process immediately as any further delay in selling the business would not be in the best interests of our shareholders, Franklins employees, suppliers and other interested groups.*
>
> *"We have been encouraged by Metcash's reports of the strong interest in acquiring Franklins' stores since the proposed sale to Metcash was announced in July. While the Franklins business as a whole has not generated an acceptable return on capital employed, Franklins' stores individually have strategic value to existing grocery operators within Australia, including but not limited to independent retailers supplied by Metcash," he said.*

This means:

1. Pick n Pay will not continue to operate Franklins because the retail model does not generate sufficient sales, the group is too small to generate economies of scale and is not viable because it cannot generate a sufficient return on investment. There will be no Franklins wholesale business.
2. There is no prospect of another single group or consortium (other than Metcash) buying the business in its current form because of the reasons outlined in the previous paragraph.
3. Only Metcash, because of its existing market share, could generate benefits for existing and potential IGA bannered independents and consumers.
4. Any other individual or consortium which purchased the Franklins stores would therefore access supply of product only through Metcash or face the same problems currently experienced by Franklins.

The ACCC will recall that the current Franklins stores were those denied to Woolworths and Coles when the previous owners of the Franklins brand, Dairy Farm International, exited the industry in Australia.

We presume, therefore, that neither Woolworths nor Coles would be permitted to acquire any of the stores previously denied them by the ACCC.

Metcash has offered to acquire the retail and wholesale divisions of the Franklins business, on-sell the corporate stores to new independent operators and honour the franchise commitments to supply the remaining eight stores, which is effectively the same result as 3 above. In our view, sale of the wholesale and retail divisions to Metcash is the only practicable outcome.

Acquisition of the Franklins business would generate benefits to retailers and consumers in New South Wales

Metcash is the major wholesale supplier to independent grocery retailers in New South Wales, although the independents' market share in that state lags behind levels achieved elsewhere in Australia, with Western Australia the outstanding example. Western Australian independents account for 30.9 per cent of the retail grocery market.

Acquisition of the Franklins stores and on-selling to suitable independents would bring a number of benefits to the independent supermarket sector in New South Wales and to their customers, for the following reasons:

- The additional market share supplied through Metcash would increase economies of scale for all IGA independents in the State
- Current market share of IGA independents in NSW is 11.2 per cent, compared with 30.9 per cent in Western Australia
- Supply of the Franklins store through the Metcash distribution centre would increase the independent sector's market share in NSW from 11.2 per cent to 18.0 per cent, with consequent increases in supplier support and advertising and marketing spend.

> The industry bench mark for advertising spend is one per cent of retail sales, which would translate to an increase in advertising spend of more than $5 million.

The potential benefits to all IGA independent grocery retailers in NSW are obvious.

As a strengthened independent sector with additional total market share was able to attract stronger marketing support from suppliers, consumers would also benefit from specials, lower shelf prices and a more vigorous competitive environment.

Market definition

Paragraphs 48-59 deal with both wholesale and retail markets.

The wholesale market issues are irrelevant, for the reasons outlined in the previous section.

Retail stores acquired by Metcash and on-sold to independent owners would benefit from the greater buying volumes Metcash is able to achieve. That accounts immediately for 80 of the 88 existing Franklins stores.

The other stores are currently supplied by Franklins wholesaling division. They, too, would benefit from having access to products at lower prices because of the greater volumes purchased by Metcash, not only packaged groceries but also fresh produce.

However, the option would remain open to any independent, as now, to source fresh produce from specialist wholesalers.

There are many specialist wholesalers and importers of both fresh produce and packaged goods and any independent is free to access supply of an admittedly limited range of products from those sources.

Paragraphs 60-62 attempt to define the market(s) which might be affected by the proposed acquisition of Franklins.

These paragraphs, however, miss the essential point: Franklins has failed in both the wholesale and retail markets because it is unprofitable and unviable for the longer term. The Pick n Pay decision to exit the market needs to be understood in that context.

By incorporating the existing Franklins-bannered stores into a larger, viable group with the capacity to increase the marketing spend, offer a larger product range and proven retail operational support, these stores have the potential to become more price competitive and offer other consumer benefits.

These other consumer benefits are significant in winning and retaining customers.

Paragraph 65 invites comment on market definition. Regardless of attempts at theoretical definitions of market, the fundamental issue is whether a retailer, large or small, can deliver product to customers at prices customers are prepared to pay.

There is limited price elasticity at retail level. Customers will trade off price against other considerations, such as convenience, but that trade-off is not necessarily large. There comes a price point beyond which convenience is generally discounted.

There is a parallel tension in the development and marketing of new products. Many new products fail because they reach the market at retail prices customers are not prepared to pay.

Supermarket shoppers are intelligent and perceptive and do not have unlimited financial resources. They will change their shopping decision depending on circumstances. In that sense, supermarket customers are the real drivers of competition.

Paragraphs 69-71 outline issues of concern and put the ACCC's preliminary view that the proposed acquisition would lead to a substantial lessening of competition.

We reject that proposition for the all of the reasons outlined above, in particular, the strengthening of the independent sector's capacity to compete with the major chains and to deliver the real consumer benefits mentioned earlier.

The ACCC posits that Metcash would be "likely to have significantly greater unilateral market power".

We would consider that if a wholesaler which would supply about 18 per cent of the NSW post-acquisition market could increase its market power vis a vis Woolworths and Coles with 80 per cent of the market (or near 90 per cent in NSW), then that would be beneficial to independent retailers and consumers alike.

At retail level, 80 Franklins stores would become 80 independently-owned stores, clearly not a substantial lessening of competition. Eight stores currently supplied by Franklins wholesale business would continue to be supplied by Metcash, but on more beneficial and price-competitive arrangements.

The ACCC also seems to assume, wrongly, that independent grocery retailers, whether or not bannered IGA would not, could not and do not compete with each other. That is manifestly untrue.

Paragraph 72 misunderstands the process which has taken place within the Franklins business.

The ACCC states that "market inquiries have provided some evidence of independent retailers switching their wholesale supply from Metcash to Franklins." One store went from Metcash to Franklins.

Franklins initiated its franchise offer as a way of generating income. Franklins had never reported a profit under its Pick n Pay ownership until it generated a cash flow through the sale of franchises. We believe that was a profit from sale of property, not a trading profit.

And after four years of offering franchises, they had succeeded in convincing only eight parties to take up that offer. Clearly, apart from the inconsequential eight franchise arrangements entered into, Franklins potential franchisees did not find their offer attractive, presumably because of their limited market presence, limited range, lack of promotional spend and uncompetitive prices.

Only one store previously supplied by Metcash through IGA Distribution switched to Franklins.

These are the reasons Franklins stores are on the market.

IGA Distribution, IGA Fresh, Australian Liquor Markets and Campbells Cash & Carry, supply thousands of retail customers in New South Wales and have no trouble attracting new retailers to the ranks of independents.

Paragraphs 73-76 are contradicted by reality. There is no second wholesaler of any significance in Victoria, South Australia or Western Australia. SPAR offers wholesale products for sale to independents, mainly in Queensland, but has a slightly smaller product range than Franklins, according to the *Issues Paper.*

In Western Australia, independents have the highest market share of any state independent grocery retailing sector, supplied by the same Metcash which the ACCC claims is constrained by the "real competitive 'threat'" of Franklins' inconsequential and ultimately unprofitable offer. It bears repeating: that is why Pick n Pay is exiting the market.

On what basis could the ACCC's "market inquiries" lead to the conclusion that "Franklins has been and continues to be a vigorous competitor and real alternative to Metcash for the wholesale supply of packaged groceries in NSW"? We note that the ACCC's letter to market participants, dated 30 July 2010, says:

> *In 2005, Franklins established its own distribution and logistics capabilities and buying team (the **Franklins wholesale business**).*

The words in parentheses are not an accurate restatement of the first part of the sentence. Franklins sub-contracted its warehouse operations and logistical services. Its "wholesaling" covered eight stores, all with the Franklins banner. This does not reflect the dictionary definition of "wholesale".

How does a "vigorous" competitor manage to achieve only eight customers in four years, only one of them an independent?

Independent grocery retailers in NSW have, almost unanimously, ignored the Franklins offer. As a direct consequence of that, rather than inject more funding from South Africa to keep the Franklins wholesaling and retailing operations afloat, Pick n Pay have decided to acknowledge that their venture has failed. They are exiting the market and nothing the ACCC claims to have learned from its "market inquiries" will alter that fact.

Franklins is withdrawing from the wholesale and retail markets because their "wholesale" and retail businesses are unviable and do not generate a sufficient return on investment. They are exiting the Australian market.

Paragraphs 77 and 78 The ACCC's "market inquiries" claim that Metcash has been constrained by "the alternative supply model offered by Franklins" - that is, a supply model which supplies an inconsequential number of stores.

The "market inquiries" are said to have uncovered concerns that, unconstrained by Franklins, Metcash might impose harsh conditions on retailer customers if the already largely ignored wholesale offer by Franklins were to be extinguished.

Many independent retailers are substantial businesses, within their local market, within their state or nationally. They communicate with each other regularly through the IGA Retail Network.

In most states, including those where independents currently have a much larger market share than they do in NSW, as we have seen already, there is not and there has never been a wholesale competitor to Metcash, yet these retailers compete vigorously and effectively and have mutually beneficial working relationships with Metcash and IGA Distribution.

On what basis would Metcash want to alienate its retail customers in NSW when it doesn't do so in other places where none of the "constraint" allegedly generated by Franklins exists right now?

Paragraph 79 claims that "market participants" have raised concerns that the loss of the

"...high profile 'No Frills' private label product would remove a constraint on other supermarkets' generic brands, and in particular on Metcash's wholesale pricing of Black and Gold products".

The No Frills brand was once both high profile and effective. It faded away with the Dairy Farm International sale of most of the Franklins business to Woolworths nearly a decade ago and now consists of only about 500 product lines.

No Frills is now "high profile" in only 88 of the 8700-plus grocery retailers in Australia.

Its total market share, which is solely in NSW, is about 0.1 per cent of national grocery sales and about 0.5 per cent of the NSW market. Total private label sales account for about 11.5 per cent of national grocery sales.

When the Franklins brand was reduced to only 80 odd stores it lacked the market bulk to maintain the former range of No Frills products. The No Frills lines now on the market are a small part of the range that was available pre-2001.

Clearly, nobody uses No Frills as the benchmark for the pricing of their generic offer.

In any case, Woolworths and Coles have expanded their private label offers for the past decade and are now the dominant players in this market segment. We are surprised that the ACCC and the unnamed "market participants" are concerned with the impact on Black&Gold products, but not with the much greater market share held by Woolworths and Coles private label products.

Paragraphs 80 discusses barriers to entry and the situation which might obtain when Franklins exits the market.

The ACCC postulates that barriers to entry are substantial, although they were not for Pick n Pay or Aldi. During the grocery pricing inquiry, the Rudd government amended Foreign Investment Review Board requirements to facilitate purchase of sites by foreign entrants.

The ACCC's "market inquiries" again claim that a new wholesaler entrant would need to have access to a large number of retailers as customers. That is precisely why Franklins has failed. They lacked critical mass.

Another option is to develop a niche format, such as Costco has introduced.

It is unclear whether the ACCC's current concern extends to the potential removal of constraint on Woolworths and Coles when Franklins exits the market.

Paragraphs 81-88 miss the point mentioned above. Franklins lacked critical mass and could not persuade a sufficient number of other grocery retailers to join them.

When Pick n Pay entered the market, they were supplied by Metcash. After setting up their own supply chain they failed because they were no longer price competitive.

Had they continued to source product from Metcash, they would probably have survived in the market, as many other groups continue to do. FoodWorks claims to be Metcash's largest single customer, but there is no evidence that FoodWorks has attempted to set up its own wholesale warehouse.

The market power of Woolworths and Coles would suggest that either could choose to enter the wholesale market, but they have not. Woolworths had followed that course with Australian Independent Wholesalers in the 1990s, but failed.

Constraint imposed by vertically integrated chains

Paragraphs 89-91 claim that Metcash faces "indirect" competition from the vertically-integrated chains. This is untrue.

Because of the interdependence of Metcash and its retailer customers, both parties face very direct and daily competition from the major chains.

Metcash competes directly with the chains by passing on to retailers not only competitive shelf prices, but the benefits of suppliers' specials, case deals and terms. Without that genuine support, independent retailers would be severely disadvantaged in their competition with the chains. The ACCC needs to understand that promotional activity in the grocery industry is initiated by suppliers, who offer periodic specials, case deals and trading terms to encourage sales of their products. These deals generally rotate through the industry, some a few times a year, some more or less permanently.

For example, the Cadbury's chocolate range is continuously on special around Australia in one or other supermarket banner. As the major wholesaler, Metcash is the lynchpin in those arrangements, negotiating with suppliers and passing on the benefits to their retail customers to allow them to offer the same prices as the chains.

The ACCC *Issues Paper* puts forward no evidence whatsoever that "independent retailers are in many cases unable to compete on price with the supermarkets". As indicated earlier, that statement is almost certainly invalid because it almost certainly does not compare like with like. Smaller IGA stores' prices should be compared not with Woolworths or Coles 5000 square metre supermarkets in major urban shopping centres, but with the prices charged in the major chains service station convenience stores. These smaller stores are, perhaps, the "many cases" to which the ACCC refers.

The ACCC attributes "incentives" to Metcash to extract profit at the wholesale level, while ignoring the impact that will have on its retailer customers' shelf prices. That is demonstrably untrue. As indicated above, suppliers would not offer specials, case deals or other terms benefits if Metcash was failing to pass them on to retailers to allow them to compete and generate extra sales.

The ACCC asserts in the *Issues Paper* [Paragraph 91] that Metcash sets its wholesale prices under the umbrella of Woolworths and Coles prices.

Assuming for the purpose of this submission that the ACCC's assertion is correct, does that not mean that the umbrella itself is the problem? Woolworths has reported single digit increases in sales for the past 11 years, while reporting double digit profit increases each year.[27]

The ACCC's grocery inquiry report said the commission had received submissions from "some interested parties" that prices charged by Metcash to its retailer customers did not allow those customers to make a sustainable margin on dry, chilled or frozen products.[28]

> *Further, some interested parties, submitted that the price paid by independent retailers would be more comparable to the MSCs if Metcash was operating in a more competitive wholesaling environment.*
>
> *FoodWorks estimated that the difference in wholesale costs faced by small independent retailers relative to the MSCs is 'in the order of 2 per cent'...*

The ACCC then quoted[29] Metcash's submission that

> *...anecdotal evidence suggests that the level of promotional terms and other discounts obtained by the MSCs is around 2% higher than obtained by Metcash.*

While it is not possible to prove that the two figures of two per cent are connected, it seems logical and highly probably that any difference in terms obtained by any wholesaler from suppliers would be passed down the supply chain to retailer customers. Differential pricing between the chains and Metcash can be explained by reference to the abolition of the former

[27] "Woolworths posts its 11th straight double-digit profit growth and a $2 billion profit", *The Courier-Mail,* 27 August 2010, www.couriermail.com.au/business/woolworths-posts-its-11th-straight-double-digit-profit-growth-and-a-2billion-profit/story/ebfreqmx-1225910634472

[28] op. cit., p. 140

[29] ibid., p. 141

s49 prohibition on anti-competitive price discrimination in 1995. Australia and New Zealand are now the only two OECD countries which do not have such a prohibition.

Paragraphs 92-96 indicate the ACCC's view that "the risk of losing business to Franklins provides a significant constraint on Metcash over and above the indirect constraint imposed by the vertically-integrated chains."

Franklins owns/supplies a total of 88 stores, all of them in NSW. .

Franklins failed to take business away from either Metcash or Metcash-supplied independents at any time since 2001, but most certainly not during the four years in which it operated its own wholesaling business.

That is a matter of historical record.

Supermarket customers will determine which groceries they buy, at what price and where they shop. If independent retailers cannot effectively market their offer and products because lack of market share limits the available marketing dollars they will lose sales.

In NSW, the combined market share of Woolworths and Coles approaches 90 per cent. While the ACCC apparently sees no need for that market power to be constrained, there is certainly little constraint generated from either Aldi or Franklins.

Further information

Franklins, as a wholesaler, has been supplying eight stores. That is, they have franchised seven stores in the past four years and attracted one other independent retailer as a wholesale customer. That does not qualify Franklins as a "threat" or even a serious "competitor" in the wholesale market. In any case - and we say it again - Pick n Pay is exiting the market because the Franklins business, both wholesale and retail, is unviable because it has not generated an adequate return on investment.

Franklins is not a constraint on Metcash. The constraint on Metcash is that it must be able to deliver to its retailer customers, in a timely manner, a large range of product at prices which will allow them to compete with Woolworths and Coles, the companies which share 80 per cent of the market. That applies to both normal shelf prices and specials. In that sense, it is the needs of Metcash's own retailer customers which will constitute constraint, along with competition from the chains.

No other company will replace Franklins as a wholesaler. Woolworths bought, then shut down the Cannons wholesale business, opened then closed Australian Independent Wholesalers because they were unable to compete with Metcash, even with the vast advantages of unparalleled market power. There is simply no room for a second major wholesale grocery business, neither within New South Wales, nor nationally.

Benefits will flow to the independent sector and to consumers from the closure of Franklins retail business. Acquisition of the Franklins corporate stores by independents would add to the turnover of the sector and generate additional marketing dollars for IGA-bannered stores in New South Wales while attracting greater supplier support and resulting in greater consumer benefits in terms of better service levels and lower prices.

Paragraphs 125-134 deal with the ACCC's theories on what might or might not happen to the market for the supply of fresh produce to independents.

Nothing will happen post-acquisition that is different from what is happening now in NSW. Whether the acquisition goes ahead or not, NSW independent retailers will acquire supplies of fresh produce to suit their requirements - either from IGA Fresh, from fresh markets or from other wholesalers. IGA Fresh will face the same competition in NSW as it currently faces in other states.

Paragraphs 135-140

We understand from the *Issues Paper* that Metcash intends to on-sell the Franklins retail stores to independents.

Unlike the major chains, an independent operator needs to begin making a profit from the first week he/she opens the business.

A potential independent buyer of one of the stores currently bannered Franklins would need to be certain that the local market could support two vigorous competitors before committing to such a purchase.

Addendum

Pick n Pay board statement

PWK/PIK - Pick n Pay Holdings/Pick n Pay Stores - 11 Oct 2010

PWK PIK

PWK PIK

PWK/PIK - Pick n Pay Holdings/Pick n Pay Stores - Pick N Pay Sale of Franklins

Update

Pick n Pay Holdings Limited

(Incorporated in the Republic of South Africa)

(Registration number 1981/009610/06)

Share code: PWK ISIN code: ZAE000005724

Pick n Pay Stores Limited

(Incorporated in the Republic of South Africa)

(Registration number: 1968/008034/06)

Share Code: PIK ISIN code: ZAE000005443

PICK N PAY SALE OF FRANKLINS UPDATE

Pick n Pay Stores Ltd today provided an update on the proposed sale of its Franklins business to Metcash Trading Limited. This included its strategy to effect the timely exit of the Australian business in the event the deal previously announced is not approved by the Australian Competition and Consumer Commission (ACCC).

The alternative exit strategy is the sale of the Franklins stores and other strategic assets individually or in groups via a tender process.

However, the company said it would continue to work closely with the ACCC to secure approval of the proposed sale to Metcash as its preferred option, and was confident in its arguments to persuade the ACCC to approve it.

On 22 September 2010 the ACCC released its Statement of Issues as part of its review of the proposed sale of Franklins to Metcash. Given the concerns raised in the ACCC`s Statement of Issues and the fact that Pick n Pay has received no other offers for the business since the strategic review was announced in April this year, Pick n Pay considered it appropriate to initiate the alternative exit strategy. The ACCC is expected to make its final decision on or before 11 November 2010.

Pick n Pay Chairman Gareth Ackerman commented: "Following the strategic review announced earlier this year, Pick n Pay took a decision to exit the Australian market. Our preferred option to achieve this is through the sale of Franklins to Metcash. While our first priority is to complete the sale to Metcash, we considered it prudent to put in place an alternative exit strategy in the event the ACCC does not approve the sale to Metcash.

"The decision to sell Franklins was not taken lightly. Without the benefits of

scale in the market and in the face of unprecedented discounting by Woolworths
and Coles, we consider it essential to start this process immediately as any
further delay in selling the business would not be in the best interests of our
shareholders, Franklins employees, suppliers and other interested groups.
"We have been encouraged by Metcash`s reports of the strong interest in
acquiring Franklins` stores since the proposed sale to Metcash was announced in
July. While the Franklins business as a whole has not generated an acceptable
return on capital employed, Franklins` stores individually have strategic value
to existing grocery operators within Australia, including but not limited to
independent retailers supplied by Metcash," he said.
Pick n Pay expects to receive initial offers for the stores and brands by 26

October 2010. In conjunction with its advisors, Pick n Pay will then assess and
progress offers received for stores and brands so that it can move to complete
the alternative exit strategy in a timely fashion, should the proposed sale of
the Franklins business to Metcash not proceed.
For further information, please contact:
Tamra Veley on +27 83 251 3658 or
Dani Isaacs on +27 83 308 6260.
By order of the board
Cape Town
11 October 2010
Sponsor:
Investec Bank Limited
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