



## FTI CONSULTING'S ROLE IN THE RECENTLY APPROVED OSTRICH MERGER

# Smoothing ruffled feathers

On 14 August 2019, the Competition Tribunal conditionally approved the intermediate merger between Klein Karoo International (KKI) and Mosstrich, the two largest ostrich processing firms in South Africa. This follows the initial prohibition by the Competition Commission (CC) on 19 December 2018.

*The FTI Consulting experts working on this successful merger were **Professor Nicola Theron** (expert witness), **Willem van Lill**, **Albertus van Niekerk** & **Jonathan Jayes**.*

FTI Consulting (instructed by Adams & Adams Attorneys), acted as economic experts for the merging parties and provided economic analyses throughout the entire merger process. The economic work done by FTI Consulting encompassed site visits, data gathering, complex data analyses, writing expert economic reports, attending expert witness meetings at the CC and providing expert witness testimony before the Competition Tribunal as part of a concurrent evidence ("hot tub") process. FTI also assisted in developing the final conditions that led to the approval of the merger.

Prof Nicola Theron (Senior Managing Director and Head of Economic and Financial Consulting at FTI Consulting South Africa) acted as the expert witness for the merging parties and debated various important themes with the CC's expert witness and was cross-examined by the CC's legal counsel. The themes discussed during the hot tub covered complex economic topics such as market definition, competitive effects analyses, the counterfactual, public interest and efficiencies.

## The declining South African ostrich industry – rationale for the merger

South Africa is the largest provider of ostrich products in the world. The products can primarily be categorised as meat, feathers and leather and have a variety of uses. They are especially sought after in the international market – mainly Europe. As such, the ostrich industry has become export-oriented, earning large amounts of foreign exchange and creating local jobs on a large scale in areas such as Oudtshoorn and Mossel Bay. However, the persistence of export bans due to Avian Influenza (AI) has resulted in the slow demise of the ostrich industry. The FTI economic report and testimony showed that during export bans, ostrich processors (such as the merging parties) struggle to realise sufficient returns on meat, due to the inability to export. Low returns on investment have caused the exit of many farmers. The resultant lower throughput of ostrich volumes led to abattoirs struggling to cover their fixed costs, leading to a significant exit of ostrich abattoirs over the last two decades. This decline led to KKI and Mosstrich being the only prominent remaining ostrich processors in South Africa, with smaller players such as Gondwana (Limpopo) and Ostriland (Citrusdal) making up a small portion of slaughter volumes.

The rationale for the merger was therefore to stabilise this decline and to expand the presence of ostrich products in the export market. A higher resulting return will allow Cape Karoo (the merged entity) to offer the farmers a higher return, which will in turn incentivise farmers to produce more ostriches. Ultimately, this will increase the number of ostriches and lead to more jobs in rural towns, both at the processing plants and on ostrich farms.

## Competitive effects analysis – ostrich meat and feathers in South Africa

It was common cause that the merged entity wants to use the merger to expand its presence in the more lucrative international market. However, the CC's concern related to the effect of the merger in the South African market. Given that the merging parties are the largest processors in South Africa, the CC's concerns focussed on the creation of a "near-monopoly" and the resultant effect that the merger would have on local meat and feather prices, even though the main markets for these products are international. Importantly, the CC did not identify a concern related to ostrich leather.

In terms of ostrich meat, the product can be further segmented into three main cuts, namely fillet, steak and trimmings. Fillet and steak are predominantly sold in the export market (when possible) and trimmings are predominantly sold in the local market. Trimmings are used in value-added products such as sausages, patties, meatballs, etc. and compete with beef trimmings.

Ostrich fillet and steak are also typically sold at a price slightly below its red meat counterpart. We argued that the competitive positioning of ostrich meat relative to beef plays an important part in understanding the competitive effect of the merger on the local meat market.

Regarding ostrich feathers, the CC was concerned that the tender process facilitated by KKI (through which both KKI and Mosstrich sell feathers to downstream feather processors), would be susceptible to manipulation that could foreclose downstream feather processors.

## Public interest and efficiencies – the benefits flowing from the merger

Throughout the merger, we highlighted the strong public interest benefits of the transaction. Specifically, that the merger would provide the necessary stability to foster the growth of an export industry. There would also be increased employment as a result, both at the processors and the ostrich farms. As part of the merger, there would also be a stronger transformation imperative (via a BEE trust). The merger also presents several efficiency gains which would lead to cost-savings and enable the merged entity to expand its presence in the international market.

## Crafting appropriate conditions to alleviate competition concerns

In a merger, the purpose is to identify potential anticompetitive effects that may arise from the transaction. Any such effects may be countered with sufficient efficiency gains and/or by way of crafting appropriate conditions to alleviate concerns. With FTI's assistance, such conditions were developed to address concerns raised by the CC and third parties.

Throughout the proceedings, there were various refinements of the potential conditions. For ostrich meat, a volume condition was proposed by the merging parties, whereby the merged entity will continue to supply a specified (confidential) volume of meat in the local market. This is an innovative approach as it indirectly serves as a pricing condition, as price will be kept in check if supply is sufficient relative to demand.

Ultimately, the Tribunal approved the merger, subject to conditions that would ensure the availability of ostrich products in the local market. These conditions relate to (i) the volume of feathers available on the tender, (ii) the volume of meat available in the local market, (iii) general access to Cape Karoo's abattoir and tannery facilities, (iv) contract access to Cape Karoo's abattoir and tannery facilities and (v) employment.

The full conditions can be found on the Tribunal's website (<https://www.comptrib.co.za/>). The reasons for the decision will be released by the Tribunal at a later stage.

## Experts



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