

Part II

# **Background and evidence**

# 3 The companies and the proposed merger

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## Introduction

3.1. The proposed merger involves the purchase by MH, a subsidiary of Nutreco, of GSP from Norsk Hydro, GSP's ultimate parent company. MH and GSP are both active in the production and sale of gutted farmed salmon in Scotland. This chapter describes the companies involved (including their UK salmon feed manufacturing subsidiaries) and the proposed merger. We also describe the third UK salmon feed manufacturer, EWOS.

3.2. This acquisition is one of several proposed transactions, through which Nutreco would acquire the entire Hydro Seafood salmon farming business of Norsk Hydro, but not its subsidiary, BioMar,

which has interests in salmon feed. Local subsidiaries of Nutreco would acquire all the share capital of HSF in Norway, Valmer in France, and Fanad in the Republic of Ireland. GSP accounted for about 31 per cent of the net sales of the Hydro Seafood business in 1999. Pro forma accounts included in the share purchase agreement show that the total assets of the Hydro Seafood Group at 31 December 1999 were NOK 2,246,347,000. Using a year-end exchange rate of £1 = NOK 13.00 gives these assets a value of about £172.8 million. Norsk Hydro confirmed that the value of the assets had not materially changed by the time the proposed merger was referred to us.

3.3. The maps at Figures 3.1 and 3.2 show the salmon farms of MH and GSP.

## **Norsk Hydro**

3.4. Norsk Hydro was established in 1905. It is a public limited company, incorporated under the laws of Norway with its registered place of business in Oslo. The Norwegian Government through its Ministry of Industry and Trade holds approximately 43 per cent of its share capital. Norsk Hydro is the largest publicly-owned industrial group in Norway in terms of assets and operating revenues.

3.5. In 1996 Norsk Hydro divided its businesses into three core areas, Oil and Energy, Light Metals and Agri. Norsk Hydro had entered the salmon farming industry in 1969, but its Hydro Seafood business is no longer included in these core areas. Norsk Hydro's interests in aquaculture also include a holding through its partly-owned Danish subsidiary, KFK, in BioMar. BioMar is one of the three large UK suppliers of salmon feed (see paragraphs 3.30 to 3.42).

3.6. In 1999 Norsk Hydro reported operating income of NOK 7,735 million (about £613 million) on operating revenues of NOK 102.4 billion (£8.1 billion). Within these totals the Hydro Seafood business contributed a loss of almost NOK 5.2 million (about £400,000). (The average exchange rate for 1999 was £1 = NOK 12.62.)

3.7. The structure of Norsk Hydro's salmon feed and salmon farming businesses, including the BioMar salmon feed business, is set out in Figure 3.3, with the companies to be sold shown in bold type. Most of the Hydro Seafood subsidiaries, sub-subsidiaries and associates are not shown; the share purchase agreement lists 29 'consolidated companies', nine of which are in Scotland.

## ***Hydro Seafood GSP Ltd***

3.8. GSP was originally set up in 1973, as Golden Sea Produce, by Fitch Lovell Ltd. The company became involved in the farming, and development of farming, of several different marine species including turbot, sea bass, salmon and oysters. A public aquarium business was developed alongside the fish-farming activities. The business was based on the west coast of Scotland.

3.9. In 1983 Norsk Hydro (UK) Ltd acquired the company, and changed its name to Hydro Seafood GSP Ltd. The main focus of its business remained fish farming but the number of species was limited to salmon and turbot. The aquarium business was sold in 1987. In 1993 the turbot farming activities (which have since been sold) were transferred to Spain where the ambient conditions were more suitable.

3.10. During the early 1990s GSP's business expanded through the acquisition of salmon-farming activities in the Shetland Islands and on the west coast of Scotland as well as through the development of new sites. Production expanded in line with the Scottish industry's rapid growth, reaching 20,000 tonnes by 1999.

3.11. In 1998 GSP was hit by a major outbreak of ISA, which led to the compulsory slaughter of a large number of mature and juvenile stock in line with UK Government and EC requirements. Lack of any compensation for compulsory slaughter of stock led to a large financial loss in 1998. Norsk Hydro told us that GSP had since recovered and returned to profitability despite the resulting reduction in production in 2000.

FIGURE 3.1

**MH fish farms in Scotland as at October 2000**



Source: CC.

\*Based on production figures for 1 January to 31 December 1999.

FIGURE 3.2

**GSP fish farms in Scotland as at October 2000**

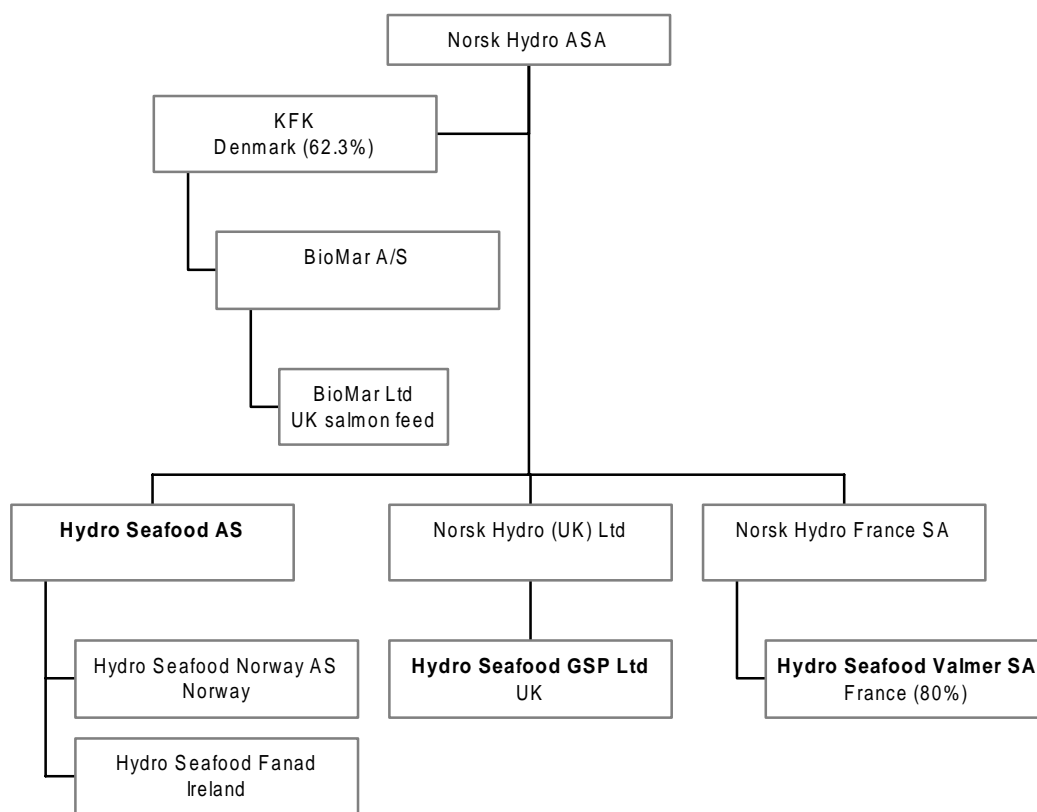


Source: CC.

\*Based on production figures for 1 January to 31 December 1999.

FIGURE 3.3

**Norsk Hydro: salmon farming businesses**



Source: Norsk Hydro.

*Acquisitions*

3.12. GSP is a limited company, 100 per cent owned by Norsk Hydro (UK) Ltd, which in turn is 100 per cent owned by Norsk Hydro ASA. GSP owns 100 per cent of Kerrera Fisheries Ltd, which it acquired in 1994 as part of the business of Kiltarity Salmon Ltd.

3.13. GSP has made several further acquisitions. In March 1996 it acquired the stocks of fish and feed of Shetland Salmon Producers Ltd (SSP) for about £5 million. In related contracts it leased plant and machinery from SSP for an annual rental of £1 million (with an option to purchase), and an option to purchase the share capital of SSP. Norsk Hydro told us that both options had been exercised and that all SSP assets were now included in GSP's balance sheet. The SSP sites and output had been included in the data that it had provided to us.

3.14. In 1997 GSP acquired assets from Summer Isles Salmon Ltd for almost £1 million. On 7 July 1999 Kerrera Fisheries acquired the business and certain assets of Nordvik Salmon Farms Ltd, another producer of gutted salmon, for £920,000 from the liquidator of Nordvik's Norwegian parent company. On the same date it also acquired Stewart Salmon Ltd and Slett Salmon Farms Ltd from the same vendor.

3.15. Norsk Hydro told us that although GSP had its own board of directors, it was directed by the Hydro Seafood group from Bergen in Norway. There was a single group strategy, together with common employment policies and financial reporting systems. However, GSP had all the elements in Scotland of a stand-alone business.

*Facilities*

3.16. GSP is divided into two regional production areas, the Scottish mainland and Shetland. The principal activities are based at South Shian, Argyll, on the west coast of Scotland and at Sand in

Shetland. Each location has a regional production office and a processing facility. Most of the marine farming sites are located in the Loch Linnhe and Sound of Mull areas, with additional sites further north on the west coast of the mainland and in north Scalloway Bay in Shetland. Juvenile salmon production for both regions is undertaken from freshwater sites, mostly on the Island of Mull and near Inverness.

3.17. GSP has 21 active sites in mainland Scotland and six in Shetland with capacities of 18,995 and 9,213 tonnes respectively (see map at Figure 3.2). There are six unutilized sites on the mainland with a capacity of 8,070 tonnes, and five in Shetland with a capacity of 2,450 tonnes. There is one undeveloped site at Bloody Bay. (Unutilized sites are those that have been used for salmon production in the past but where there has been no production for at least 52 weeks, or a fallow period has exceeded 52 weeks; undeveloped sites are those where there has never been any salmon production.)

3.18. GSP is currently using 71 per cent of its total capacity of 39,728 tonnes, while MH is using almost [ 80 ] per cent of its capacity of [ 80 ] tonnes (see paragraph 3.79). GSP said that its poor capacity utilization reflected the Government-imposed extended fallow periods at several of its sites, following the outbreak of ISA in 1998.

3.19. Processing at the factories in South Shian and Sand is limited to the removal of guts and packing in ice. The result is an industry standard 22 kg box of fresh gutted farmed salmon. No secondary processing is undertaken.

3.20. The administrative centre in Stirling provides full financial support to the two regions, and operates a sales centre for the whole of GSP. A sales office in Le Havre services the French market. In 1999, over 50 per cent of production was exported, mostly to customers in France and the USA.

### *Infectious salmon anaemia*

3.21. GSP was particularly hard hit by the first outbreak of ISA in Scotland. In its 1997 accounts GSP reported that in May 1998, following its investigations of mortalities on one of its sites, GSP notified the Scottish Office of its suspicion of the presence of ISA. The Scottish Office inspectorate confirmed the presence of ISA at the initial site and, following visits and sampling, at some of the company's other west of Scotland sites. This viral condition had not been seen previously in the EC. ISA is classified as a List 1 Notifiable Disease, so its confirmation led to mandatory removal of fish from the site, either by cull and disposal or, if the fish had reached market size, by harvest. GSP stated that the virus was incapable of replicating at human body temperature and so there was no known health risk from ISA. Although the outbreak of ISA was detected in 1998, GSP included provisions for the cost of culling at infected sites in its 1997 accounts.

3.22. In September 1998 HSF announced that, because of the disappointing financial performance of GSP, there would be a large reduction in the future scale of its Scottish activities. It said that the financial performance of GSP was the result of the poor competitive position of the Scottish salmon industry, made worse in its case by the consequences of the discovery of ISA in Scotland, including in a number of GSP farms. The financial loss would depend upon the extent of ISA and the need for eradication. The issue of financial compensation was actively being pursued with the Scottish Office. The loss for 1998 would be in the order of £10 million. Future production targets were to be reduced by 40 per cent (10,000 tonnes) and, as a result, there would be a requirement to reduce employee numbers by approximately 150, from 370 to 220, over the following six months.

3.23. ISA was later confirmed at sites operated by other salmon-farming companies in Scotland. MH, then owned by Booker plc but now a subsidiary of Nutreco, initiated legal proceedings against GSP, seeking compensation of more than £2 million for its own losses. Nutreco told us that if the merger did not take place MH would continue with its claim; if it were approved, Nutreco would reconsider its position to establish the commercially most attractive option, which might well be a continuation of the GSP claim.

## Feed purchases

3.24. Norsk Hydro told us that, like many other companies in the salmon-farming industry, GSP operated a multi-sourcing policy for its feed supplies. This allowed GSP to obtain the best-quality feed with high service levels at a competitive price. It also allowed GSP to test the efficiency of the feed in relation to the performance of the salmon. GSP had at least three main suppliers of feed as well as deliveries from a fourth feed supplier, to test the quality and performance of products provided by the other suppliers.

3.25. Norsk Hydro provided us with information on GSP's purchases of salmon feed for the three years to 1999 and its estimate for 2000, which are shown in Table 3.1.

TABLE 3.1 **GSP: purchases of salmon feed**

	1997	1998	1999	2000*
	<i>tonnes</i>			
Trouw	<div style="display: flex; align-items: center; justify-content: center;"> <span style="font-size: 3em; margin-right: 10px;">[</span> <div style="text-align: center;"> <p><i>Figures omitted. See note on page iv.</i></p> </div> <span style="font-size: 3em; margin-left: 10px;">]</span> </div>			
BioMar				
EWOS				
Havsbrún				
	<i>per cent</i>			
Trouw	<div style="display: flex; align-items: center; justify-content: center;"> <span style="font-size: 3em; margin-right: 10px;">[</span> <div style="text-align: center;"> <p><i>Figures omitted. See note on page iv.</i></p> </div> <span style="font-size: 3em; margin-left: 10px;">]</span> </div>			
BioMar				
EWOS				
Havsbrún				

Source: Norsk Hydro.

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\*Tonnes for 2000 have been estimated by GSP.

The tonnages in Table 3.1 include all feed used by GSP's own operations and, from 1999, by subcontracted farming operations. These subcontracted operations accounted for 4.0 per cent of feed usage in 1999 and are forecast to account for 7.7 per cent in 2000.

3.26. The 36.1 per cent decline in feed volumes in 1999 compared with the previous year reflects the lower stocking levels after the outbreak of ISA. Purchases from Trouw were reduced more than those from other feed suppliers, because GSP thought at that time that BioMar feed offered better performance and value for money. In 2000 GSP switched one of its main contracts from Trouw to EWOS. Norsk Hydro said that this decision was based purely on feed price and the level of service that EWOS offered. There is still some small use of Trouw feed in 2000, which reflects a rollover of stock from 1999 and the trial use of some feed to test its performance.

## Financial performance

3.27. The financial performance of GSP for the five years to 1999, as reported in its statutory accounts, is set out in Table 3.2.



TABLE 3.2 GSP: financial performance, five years to 1999

	£'000				
	1995	1996	1997	1998	1999
Turnover	24,422	41,783	38,222	45,679	54,459
Cost of sales	<u>17,749</u>	<u>35,952</u>	<u>40,350</u>	<u>49,532</u>	<u>47,114</u>
Gross profit	6,674	5,831	(2,128)	(3,853)	7,345
Distribution costs	996	1,481	1,526	2,313	4,894
Administrative expenses	<u>641</u>	<u>963</u>	<u>1,573</u>	<u>1,317</u>	<u>1,362</u>
Operating profit	5,037	3,386	(5,228)	(7,484)	1,089
Exceptional gains/(costs)	<u>0</u>	<u>0</u>	<u>(7,887)</u>	<u>(10,657)</u>	<u>414</u>
Profit before interest and tax	<u>5,037</u>	<u>3,386</u>	<u>(13,115)</u>	<u>(18,141)</u>	<u>1,503</u>
Fixed assets (net)	7,004	9,317	11,783	9,283	7,490
Ongrowing fish	16,684	30,759	34,885	29,219	21,473
Other operating assets (net)	<u>1,738</u>	<u>7,663</u>	<u>7,855</u>	<u>2,641</u>	<u>3,301</u>
Net operating assets	<u>25,426</u>	<u>47,740</u>	<u>54,523</u>	<u>41,143</u>	<u>32,264</u>
Staff costs	3,226	5,193	6,596	7,112	5,678
Average employee numbers	199	276	355	373	351
				<i>per cent</i>	
Ratios to turnover:					
Gross profit	27.3	14.0	(5.6)	(8.4)	13.5
Distribution costs	4.1	3.5	4.0	5.1	9.0
Administrative expenses	2.6	2.3	4.1	2.9	2.5
Operating profit	20.6	8.1	(13.7)	(16.4)	2.0
Exceptional gains/(costs)	0.0	0.0	(20.6)	(23.3)	0.8
Profit before interest and tax	20.6	8.1	(34.3)	(39.7)	2.8
Ratio to average operating assets:					
Operating profit	19.8	9.3	(10.2)	(15.6)	3.0
Profit before interest and tax	19.8	9.3	(25.6)	(37.9)	4.1
				<i>£ per employee</i>	
Turnover	122,726	151,387	107,667	122,464	155,153
Operating profit	25,311	12,269	(14,726)	(20,065)	3,102
Staff costs	16,211	18,816	18,581	19,066	16,176

Source: GSP.

3.28. The exceptional costs of more than £18 million in 1997 and 1998 arose from the outbreak of ISA described in paragraph 3.23. The costs of £7.9 million in 1997 were related to the costs of culling the sites where ISA had been detected. Following on from this in late 1998 HSF and GSP carried out a detailed review. A detailed plan was then put together to implement the working practices needed to comply with Scottish Office regulations and to reorganize operations to address the resulting detrimental effect on the business and its financial performance. As a result further exceptional costs were recognized in 1998:

- (a) It was deemed necessary to reduce the scale of the business due to Scottish Office regulations requiring infected sites to be fallow for a designated period. This meant that certain sites and young fish could no longer be utilized, certain contracts could no longer be fulfilled and redundancy costs were incurred. An exceptional cost of about £5.7 million was included to reflect this.
- (b) New working practices had to be introduced to comply with Scottish Office regulations resulting in additional equipment hire, equipment purchases, chartering of wellboats, and increased hygiene requirements. The related exceptional costs were about £1.8 million.
- (c) As a result of the above the carrying value of stock had to be reviewed to reflect the fact that direct costs were now spread over a lower biomass, resulting in a write-down of about £2.8 million.
- (d) GSP raised a claim for compensation against the Scottish Office relating to the forced culling of fish on sites found to have incidences of ISA, resulting in exceptional costs of £373,000 for pursuing this claim.

3.29. The impact of ISA makes it difficult to forecast GSP's future output and profitability. Its stocking densities are lower than those of other salmon farmers, including those of MH, because of the need for fallow periods at infected sites. GSP provided us with details of its actual output in 1999 (equivalent to sales) and its budgeted sales to 2002, which are set out in Table 3.3.

TABLE 3.3 **GSP: budgeted output, four years to 2002**

	<i>tonnes</i>			
	1999	2000	2001	2002
Gutted weight	[ <i>Figures omitted. See note on page iv.</i> ]			
Live weight equivalent				

Source: GSP.

Norsk Hydro told us that the forecast reduction in output in 2002 compared with 2001 was a result of new practices introduced following the ISA outbreak. GSP is limited to one generation of stock in one production area, which means that all stock from this production area will be harvested during the same period. GSP's largest production area is Loch Linnhe, and the production capacity of this area is larger than and out of balance with the production capacity of the other GSP sites, which are stocked with a different generation of salmon. The result is an annual variation in production.

### ***BioMar A/S***

3.30. Norsk Hydro owns 62.3 per cent of the share capital of the Danish company KFK, which forms part of its Agri business. KFK trades in plant nutrients and agricultural produce in Denmark and Sweden, and is listed on the Danish stock exchange. One of KFK's subsidiaries is BioMar A/S (BioMar), a leading supplier to the European fish feed market, which in turn owns all the issued shares of BioMar Ltd. BioMar Ltd is one of the three major suppliers of salmon feed in the UK. The others are Nutreco's subsidiary, Trouw (UK) Ltd (see paragraphs 3.54 to 3.73), and EWOS (see paragraphs 3.113 to 3.121).

3.31. KFK's board of directors consists of six members, four representing the shareholders and two representing the employees. Norsk Hydro appoints three of the four shareholder representatives, including the Chairman of the board, but it has no representatives on the boards of the BioMar companies. Norsk Hydro told us that the board acts in accordance with best practice, which may not always coincide with the interest of Norsk Hydro as the majority shareholder. Whilst it had a degree of ultimate shareholder control, it did not in practice exercise control at board or management level.

3.32. Norsk Hydro told us that BioMar had been excluded from the sale of its salmon-farming interests. As BioMar was owned by a listed company, KFK, any decision to sell it would have had to be taken by the board of KFK in accordance with the formal decision-making process of a Danish listed company. BioMar was an important part of KFK, and KFK had not made a formal decision to sell it. Even though Norsk Hydro as shareholder in KFK could have initiated a process of combining BioMar and Hydro Seafood, it was Norsk Hydro's assessment that a sales process which involved only Hydro Seafood was likely to involve a large number of bidders and, thus, better commercial terms. A process of combining the two groups of companies would be extremely complicated given an ownership of BioMar by an outside listed company.

3.33. In October 1996 HSF and BioMar entered into a long-term partnership arrangement, which came into effect on 1 August 1997. It was to run for a minimum period of three years, during which BioMar would have the right to supply Hydro Seafood with 50 per cent of its total fish feed requirements. There was to be long-term cooperation in areas such as research and development (R&D), training, and strategic planning. The sale of the Hydro Seafood business by Norsk Hydro caused the partnership to be terminated, and it was replaced by a three-year supply agreement (see paragraphs 3.106 to 3.109).

3.34. The BioMar group reported an operating profit for 1999 of DKK 177.9 million on net turnover of DKK 1,577.1 million. Operating profit increased by 51 per cent even though turnover fell by 6 per cent. A 29 per cent increase in operating expenses was outweighed by the effects of an increase in gross margin from 25.4 to 36.7 per cent.

3.35. KFK told us that during the last two years the BioMar group accounted for about 20 per cent of group sales, but had provided more than 50 per cent of its contribution before finance. This reflected the bad market conditions for KFK's agricultural activities. Fish feed production was a young industry compared with KFK's other activities, for more than 100 years producing feed for animals. It said that if no further concentration in UK salmon farming took place after Nutreco's acquisition of GSP, BioMar expected to keep its position in the UK fish feed market. KFK said that the group had no plans to make direct investments in salmon farming, but BioMar had shown rapid growth and it wanted to secure its position with further expansion. BioMar was establishing a joint venture in Chile with a salmon feed company and was investing in a new production plant in Greece.

3.36. KFK told us that it was not itself involved in negotiating the BioMar agreement, but BioMar had been consulted. It did not know if Nutreco would secure all its feed requirements through Trouw once the agreement ended in December 2002, but BioMar would try to sell its products to every potential customer, including those owned by Nutreco.

#### *BioMar Ltd*

3.37. In 1990 BioMar set up a Scottish subsidiary, Ecoline Ltd, which commenced trading in the following year. At first it imported and sold salmon and trout feed that had been manufactured by its parent company, and in 1993 made an operating profit of almost £80,000 on turnover of £6.4 million. In 1994 it announced its intention to build a factory on a site that it had acquired in Grangemouth on the Firth of Forth. In that year it changed its name to BioMar Ltd, reflecting a change in the name of its parent company. Production commenced at the new factory, which had an annual capacity of 35,000 tonnes, in October 1995.

3.38. BioMar told us that it had no current contracts with MH, but did have a three-year contract with GSP. It said that in the UK it occupied a premium niche, based on quality and technical support (for example, the assessment of carcass quality), while emphasizing a desire for long-term relationships; by contrast EWOS was focused on feed price, whereas Trouw was closer to BioMar.

3.39. The financial performance of BioMar Ltd is summarized in Table 3.4.

TABLE 3.4 BioMar Ltd: financial performance, six years to 1999

	£'000					
	1994	1995	1996	1997	1998	1999
Turnover	8,715	11,839	20,692	24,336	29,275	25,443
Cost of sales	<u>7,877</u>	<u>11,258</u>	<u>18,344</u>	<u>21,081</u>	<u>23,379</u>	<u>18,712</u>
Gross profit	838	581	2,348	3,255	5,896	6,731
Distribution costs	334	557	330	351	339	211
Administrative expenses	<u>532</u>	<u>2,833</u>	<u>2,639</u>	<u>2,168</u>	<u>2,245</u>	<u>3,074</u>
Operating profit	<u>(28)</u>	<u>(2,809)</u>	<u>(621)</u>	<u>736</u>	<u>3,312</u>	<u>3,447</u>
Net operating assets:						
Fixed assets	4,788	6,947	5,842	5,272	4,383	4,337
Trade debtors	2,084	3,487	5,217	6,934	9,997	9,513
Other operating assets (net)	<u>740</u>	<u>262</u>	<u>(1,539)</u>	<u>(1,384)</u>	<u>1,578</u>	<u>(839)</u>
Year end	<u>7,612</u>	<u>10,696</u>	<u>9,520</u>	<u>10,822</u>	<u>15,958</u>	<u>15,456</u>
Average	4,834	9,154	10,108	10,171	13,390	15,707
Staff costs	217	481	575	976	1,069	1,402
Average employee numbers	8	16	31	41	43	48
						<i>per cent</i>
Ratios to turnover:						
Gross profit	9.6	4.9	11.3	13.4	20.1	26.5
Distribution costs	3.8	4.7	1.6	1.4	1.2	0.8
Administrative expenses	6.1	23.9	12.8	8.9	7.7	12.1
Operating profit	(0.3)	(23.7)	(3.0)	3.0	11.3	13.5
Ratio to average operating assets:						
Operating profit	(0.6)	(30.7)	(6.1)	7.2	24.7	21.9
						<i>£ per employee</i>
Turnover	1,089,375	739,938	667,484	593,561	680,814	530,063
Operating profit	(3,500)	(175,563)	(20,032)	17,951	77,023	71,813
Staff costs	27,162	30,051	18,561	23,817	24,871	29,203

Source: BioMar Ltd.

Table 3.4 shows that BioMar Ltd reported losses for three years from 1994 while it was constructing its factory. In 1996, the first full year of operation of the factory, sales increased by almost 75 per cent from 1995. There was a significant change in the company's cost structure, as it moved from the low gross margin from acting as its parent company's sales agent to the higher gross margin associated with having its own manufacturing facility.

3.40. BioMar Ltd's gross margin has continued to increase year on year, reaching 26.5 per cent in 1999. This increase more than offset the fall in turnover in that year, so that total gross profit exceeded £6.7 million, more than twice the amount in 1997. BioMar told us that the fall in turnover was caused by a general fall in raw material prices worldwide, which had a depressing effect on the selling prices of feed. In 1999 selling prices were also affected by increased competition, the impact of which had increased significantly in 2000. Gross margins had not fallen because raw material prices had dropped in parallel to lower selling prices. By concentrating on its niche markets, it had been able to increase its gross margins in some areas.

3.41. Table 3.4 also shows the growth in net operating assets. There has been no large item of expenditure on fixed assets since the factory opened, but there has been a steady growth in trade debtors as the company has given increasing amounts of extended credit to its customers (see paragraph 4.177).

3.42. BioMar told us that the annual capacity of the Grangemouth factory had been about [ 80 ] tonnes for the last two years. This was based on working five days a week with three eight-hour shifts, but working seven days a week during periods of peak demand. It was currently engaged in a debottlenecking programme which would increase annual capacity to [ 100 ] tonnes.

## Nutreco

### *History of the group*

3.43. Nutreco is a public limited company registered in the Netherlands, with its principal office in Boxmeer. With its subsidiaries Nutreco forms an international group of companies active in the animal and fish feed industries and also salmon production and sales. The group's largest activities centre on the production of feed for pigs, poultry, ruminants (cattle and sheep) and fish as well as salmon production and sales. In addition, the Nutreco group is active in the production of premixes (vitamin and mineral mixtures) and speciality feed, poultry and pig processing, and pig and poultry breeding. The group has over 80 production and sales operations in more than 18 countries.

3.44. In September 1994 Anchor Holding BV purchased the share capital of several direct and indirect subsidiaries of The British Petroleum Company plc (BP), now BP Amoco plc, that had comprised a large part of its operating division, BP Nutrition. Anchor Holding BV was a special-purpose vehicle owned by the management of BP Nutrition, by funds advised by Cinven and BC Partners, and by other institutional investors. Anchor Holdings BV was renamed Nutreco Holding BV and began operations on 1 October 1994.

3.45. Nutreco was originally a Dutch private company (BV), and was converted into a public limited liability company (NV) under Dutch law with shares listed on the Amsterdam stock exchange in 1997. In March 1998 Nutreco and its shareholders carried out a share placement offering by which Cinven, BC Partners and other institutional investors sold their shareholdings and new shares were issued by the company. The shares in Nutreco are now widely dispersed. Under Dutch law shareholdings of 5 per cent or more must be notified. Nutreco has received three such notifications: ING holds 10 per cent, the Fortis Group holds 5 per cent and Aegon NV also holds 5 per cent of ordinary shares.

3.46. From 1999 Nutreco reported its consolidated financial statements in euros rather than Dutch guilders, converting results for earlier years at the rate that became irrevocably fixed on 1 January 1999 of €1 = NLG 2.20371. The financial performance of Nutreco since 1995 is set out in Table 3.5.

TABLE 3.5 Nutreco: financial performance, five years to 1999

	<i>€ million</i>				
	1995	1996	1997	1998	1999
Sales	1,827	2,068	2,193	2,465	2,601
Cost of sales	<u>1,384</u>	<u>1,586</u>	<u>1,682</u>	<u>1,840</u>	<u>1,880</u>
Gross profit	443	482	511	625	721
Operating expenses	<u>389</u>	<u>425</u>	<u>443</u>	<u>543</u>	<u>624</u>
Operating profit	<u>54</u>	<u>57</u>	<u>68</u>	<u>82</u>	<u>97</u>
Net operating assets:					
Year end	345	338	345	382	574
Average	345	342	342	364	478
Staff costs	170	178	187	227	256
Average employee numbers	5,553	5,458	5,430	6,334	7,754
				<i>per cent</i>	
Ratios to turnover:					
Gross profit	24.2	23.3	23.3	25.4	27.7
Operating profit	3.0	2.8	3.1	3.3	3.7
Ratio to average operating assets:					
Operating profit	15.7	16.7	19.9	22.5	20.3

Source: Nutreco.

Applying the average exchange rate used by Nutreco for 1999 of £1 = €1.52, its operating profit was £63.8 million (€6.9 million) on net sales of £1,711.0 million (€2,600.7 million).

## Nutreco Aquaculture

3.47. The Nutreco group is organized into two businesses, Nutreco Agriculture and Nutreco Aquaculture (Agri and Aqua). BP Nutrition had been involved in fish feed since 1975 when it acquired two-thirds of Trouw & Co NV, a private company based in the Netherlands with operations throughout Europe. In 1980 Trouw International entered the salmon feed market with the acquisition of Skretting, a Norwegian company that had been the first to introduce extruded fish feed. In 1988 BP Nutrition acquired a fish-farming company in Chile, and by the time of its flotation Nutreco Aquaculture had fish-farming operations in Chile and Canada, but not in Europe.

3.48. Nutreco Aquaculture now has two business groups:

- (a) *Aqua Feed Europe*. This group consists of the following business units: Skretting (Norway), Trouw UK/Ireland and Trout & Marine (rest of Europe and Japan). These are all fish feed sales and manufacturing companies, manufacturing feed primarily for salmon, trout and marine species.
- (b) *Aqua International*. This group includes both salmon farming and fish feed sales and manufacturing companies and consists of Marine Harvest Scotland, Trouw Chile, Marine Harvest Chile and Moore-Clark (Canada).

3.49. Table 3.6 shows Nutreco's results by business segment for the five years to 1999.

TABLE 3.6 Nutreco: results by business segment, five years to 1999

	<i>€ million</i>				
	1995	1996	1997	1998	1999
Sales:					
Agri	1,448	1,623	1,633	1,841	1,910
Aqua	<u>380</u>	<u>445</u>	<u>560</u>	<u>624</u>	<u>690</u>
	<u>1,828</u>	<u>2,068</u>	<u>2,193</u>	<u>2,465</u>	<u>2,601</u>
Operating profit:					
Agri	36	38	42	54	47
Aqua	<u>25</u>	<u>27</u>	<u>34</u>	<u>38</u>	<u>58</u>
	60	65	76	91	106
Corporate overheads	<u>(6)</u>	<u>(7)</u>	<u>(8)</u>	<u>(9)</u>	<u>(9)</u>
	<u>54</u>	<u>57</u>	<u>68</u>	<u>82</u>	<u>97</u>
					<i>per cent</i>
Operating margin:*					
Agri	2.5	2.3	2.6	2.9	2.5
Aqua	6.4	6.1	6.1	6.0	8.5
Share of sales:					
Agri	79.2	78.5	74.5	74.7	73.5
Aqua	20.8	21.5	25.5	25.3	26.5
Share of operating profit:					
Agri	59.4	58.0	55.4	58.7	44.8
Aqua	40.6	41.8	44.6	41.3	55.2

Source: Nutreco.

Table 3.6 shows the increasing importance of the Aqua business to Nutreco. Over the five years it has been accounting for an increasing proportion of sales but, because of its higher profitability, for a much greater proportion of its operating profit. In 1999, during which it acquired the Marine Harvest businesses in Scotland and Chile, Aqua contributed €58.4 million (£38.4 million) to operating profit, an increase of 54.9 per cent on the previous year, overtaking Agri for the first time.

3.50. Nutreco commented on its 1999 performance in its annual report. It said that the downward trend in world market prices of fish meal and fish oil (the main raw materials for Nutreco Aquaculture), which set in during the first half of 1998, had persisted throughout the first half of 1999, with prices levelling out towards the end of 1999. End prices of salmon and salmon products were better in 1999 than in 1998, which partly explained the disproportionate rise in the gross margin compared with sales growth. Partly owing to acquisitions made in 1999, Nutreco had been able to increase its market share in the UK and Ireland. The Marine Harvest farms were now increasingly using Nutreco salmon feed.

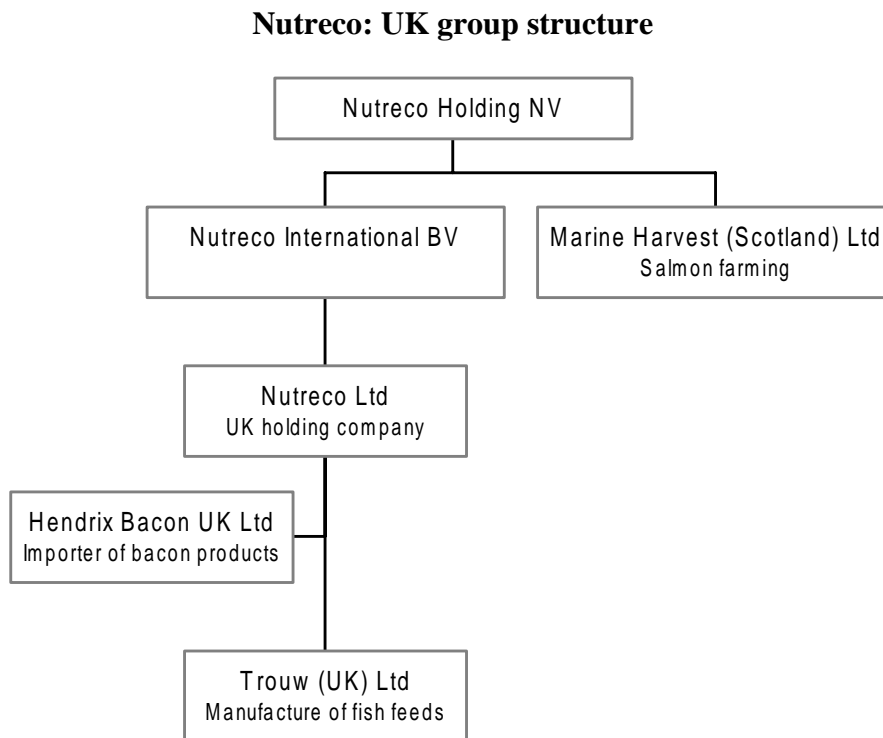
3.51. Commenting on its ambitions for 2000 and later, Nutreco said that it was aiming to strengthen still further its position as a world market leader in the rapidly growing salmon markets. Nutreco Aquaculture aimed to draw the fullest possible benefit from market growth and to strengthen still further its positions in feed for salmonids and other fish species. In addition it was aiming to build on its existing strong positions in the salmon food production chain, from breeding to international marketing and the sale of end-products.

### ***UK organization***

3.52. Following its demerger from BP, Nutreco placed all its UK interests within a holding company, Nutreco Ltd. These interests consisted of the entire share capital of Trouw (UK) Ltd and of Hendrix Bacon UK Ltd.

3.53. In July 1999 Nutreco group companies made two acquisitions in the UK. First, Nutreco Holding NV acquired Booker Aquaculture Ltd (trading as Marine Harvest McConnell), which operated salmon farming and processing facilities in Scotland and Chile, changing its name to Marine Harvest (Scotland) Ltd. Second, Trouw acquired the fish feed business of BOCM. The structure of Nutreco's UK companies following these acquisitions is shown in Figure 3.4 (non-trading companies are not included). All companies are 100 per cent owned by the Nutreco group.

FIGURE 3.4



Source: Nutreco.

### ***Trouw***

3.54. When the BP Group acquired Trouw & Co NV in 1975, both companies were manufacturing fish feed for the freshwater trout-farming industry. From 1977 trout feed in pelleted form was manufactured at the Trouw factory in Longridge, near Preston, but there was at that time a move to extruded feed because of its superior performance. During the late 1970s BP Nutrition (UK) manufactured pelleted feed for the emerging salmon market at Witham in Essex, but during the early 1980s it decided for nutritional reasons (as for trout) to market extruded diets. In 1986 it opened a new factory at Invergordon on the Firth of Cromarty with one pelleting and one extruder line. By 1993 Longridge had to be converted to an extruder line producing only fish foods.

3.55. Trouw now manufactures fish feeds at Longridge and Invergordon, and at the recently acquired BOCM site in Renfrew. Trouw benefits from research at Nutreco's Aquaculture Research Centre in Stavanger, Norway. In addition to fish feeds Trouw manufactures and markets agricultural and speciality feeds, as part of Nutreco's Agri business.

3.56. Since Nutreco was formed in 1994, Trouw's aquaculture business has incurred £[ ] million of capital expenditure, of which £[ ] million was for the installation of additional capacity, and £[ ] million for improving the business and its sites.

3.57. Trouw's financial performance for the six years to 1999 is summarized in Table 3.7.

TABLE 3.7 Trouw: financial performance, six years to 1999

	1994	1995	1996	1997	1998	1999
Turnover	84,946	88,766	95,675	104,773	102,725	96,861
Cost of sales	<u>74,419</u>	<u>79,987</u>	<u>84,387</u>	<u>90,070</u>	<u>88,321</u>	<u>79,929</u>
Gross profit	10,527	8,779	11,288	14,703	14,404	16,932
Distribution costs	3,488	3,264	2,510	3,928	4,438	4,116
Administrative expenses	<u>3,579</u>	<u>3,783</u>	<u>4,948</u>	<u>3,932</u>	<u>4,467</u>	<u>5,516</u>
Operating profit	<u>3,460</u>	<u>1,732</u>	<u>3,830</u>	<u>6,843</u>	<u>5,499</u>	<u>7,300</u>
Net operating assets:						
Year end	15,831	16,898	16,387	15,853	18,311	22,781
Average	15,831	16,365	16,643	16,120	17,082	20,546
Staff costs	6,583	6,681	6,898	7,871	7,756	8,421
Average employee numbers	300	291	290	289	282	313
						<i>per cent</i>
Ratios to turnover:						
Gross profit	12.4	9.9	11.8	14.0	14.0	17.5
Distribution costs	4.1	3.7	2.6	3.7	4.3	4.2
Administrative expenses	4.2	4.3	5.2	3.8	4.3	5.7
Operating profit	4.1	2.0	4.0	6.5	5.4	7.5
Ratio to average operating assets:						
Operating profit	21.9	10.6	23.0	42.5	32.2	35.5
						<i>£ per employee</i>
Turnover	283,153	305,038	329,914	362,536	364,273	309,460
Operating profit	11,533	5,952	13,207	23,678	19,500	23,323
Staff costs	21,943	22,959	23,786	27,235	27,504	26,904

Source: Trouw.

3.58. From Table 3.7 we calculated that in 1999 Trouw accounted for about 5.7 per cent of Nutreco's sales and 11.4 per cent of its operating profit (these percentages reflected the total of Trouw's activities including Trouw Aquaculture). Trouw's profitability has improved since the demerger from BP in 1994 because of an increase in gross margin of more than five percentage points. Trouw told us that Trouw Aquaculture (as part of Trouw) had benefited from the growth of the salmon industry and also from improvements in efficiency, as well as the recent fall in raw material costs. Net operating assets increased by almost £4.5 million in 1999, reflecting the acquisition of the fish feed business of BOCM.

3.59. [

*Details omitted. See note on page iv.*

]



[

*Details omitted. See note on page iv.*

]

### *Acquisition of the BOCM Fish Feed Group*

3.60. Trouw was expanded in July 1999 when it purchased the BOCM Fish Feed Group, a division of BOCM, which was then the smallest of the four UK fish feed producers, being fourth in salmon feed and second in the relatively small trout feed market. It also exported feed for sea bass and sea bream feed to Greece, Cyprus and other Mediterranean countries. It had one production plant in Renfrew, near Glasgow, which had been involved in the manufacture of animal feeds since the late 1950s. At the time of the acquisition it was capable of producing over 20,000 tonnes of fish feed a year on two old extruder lines (which have since been replaced).

3.61. BOCM's management had bought the company from Elementis plc (formerly Harrisons & Crosfield plc) in December 1998. Nutreco told us that although BOCM was the largest UK company in compound feed (and so a competitor of Trouw), it had decided that its fish feed business was non-core. There were limitations because it operated only in the UK and faced multinational competitors.

3.62. In its assessment of the Fish Feed Group's business, Nutreco said that its policy of 'least cost, lowest price' had led to its low market share and a perception of lower-quality feed. In reality its diets were of acceptable quality, competitively priced and performed well. Despite perceived and real limitations, it had been a significant threat to Trouw Aquaculture UK and other competitors because of its ability to undercut every other company's prices in most quotations.

3.63. The July 1999 purchase transaction involved the acquisition of the fish feed trading assets from BOCM, and [ *Details omitted. See note on page iv.* ]. Since its acquisition, capacity, efficiency and product quality have been increased by the installation of two new extruders.

### *Production capacity and forecast demand*

3.64. Nutreco told us that Trouw had prepared a development plan that included forecasts of demand for salmon feed for each of the four years from 2000 to 2003, based on the SOAEFD salmon biomass model. It had also forecast the tonnages that would be delivered to each major account by BioMar, EWOS and itself, and the volume taken by imports. When it drew up the plan in May 2000, Trouw was aware of Nutreco's planned acquisition of GSP and of the BioMar agreement. It also knew the percentages by which GSP's purchases from BioMar could [  $\approx$  ], but not the initial tonnage for 2000. Trouw assumed that BioMar would sell [  $\approx$  ] tonnes to GSP in 2000; the tonnage specified in the BioMar agreement is shown in paragraph 3.106.

3.65. Trouw's forecast of salmon feed volumes and the market shares of the major suppliers is summarized in Table 3.8.

TABLE 3.8 Trow: forecast of salmon feed volumes, 2000 to 2003

	<i>tonnes</i>			
	2000	2001	2002	2003
Salmon production	[ <i>Figures omitted. See note on page iv.</i> ]			
Feed volume				
	<i>per cent</i>			
Market shares:				
Trow	52.5	57.9	60.0	66.7
BioMar	19.5	19.1	17.9	18.1
EWOS	21.1	18.2	17.3	14.1
Imports	6.9	4.8	4.8	1.2
	<i>tonnes</i>			
Trow	[ <i>Figures omitted. See note on page iv.</i> ]			
BioMar				
EWOS				
Imports				

Source: Trow.

3.66. We sought to measure the degree of concentration in the UK market for salmon feed, using Trow's forecast market shares to calculate the HHI. The HHI, or Herfindahl-Hirschmann Index, is a measure of market concentration, calculated by summing the squares of the market shares of all market participants. It is used by the US competition authorities, whose 1992 guidelines suggest that an HHI up to 1,000 indicates a market that is relatively unconcentrated, a value between 1,000 and 1,800 indicates moderate concentration, and a figure of 1,800 or more indicates high concentration. Using Trow's estimate of market shares in 2000, the HHI is about 3,600 and, if Trow's forecasts are correct, the market will become even more concentrated by 2003.

3.67. Nutreco gave us details of Trow's sales volumes and capacity utilization, based on working 24 hours a day, five days a week for the three years to 1999, including requirements for trout, fry and other marine species, and we have set them out in Table 3.9.

TABLE 3.9 Trow: sales volumes versus capacity, 1997 to 1999

Year	Sales (tonnes)	Capacity (tonnes)	Utilization %
1997	[ <i>Figures omitted. See note on page iv.</i> ]		
1998			
1999			

Source: Nutreco.

No sales of sea bass or sea bream are included in these numbers until August 1999, when Trow inherited this business with its acquisition of the BOCM Fish Feed Group. Nutreco told us that the capacity shortfall in 1998 was covered by weekend working and overtime, and by some pre-stocking. About [ ] tonnes of sales were of trout feed (for which Trow estimated its UK market share to exceed [ ] per cent) and [ ] tonnes for fry feed and feed for other marine species.

3.68. In 1999 Trow gained additional capacity by de-bottlenecking its Invergordon plant, giving an additional [ ] tonnes of annual capacity. The purchase of the BOCM Fish Feed Group gave a further [ ] tonne annual capacity, so Trow will have capacity of [ ] tonnes for 2000. As a result of further investment at Renfrew and Longridge, Trow's capacity will reach [ ] tonnes a year by the end of 2000. Nutreco also told us that production of sea bass and sea bream feeds for export customers was planned to be transferred to non-UK subsidiaries at some point during 2000, releasing capacity for salmon feed. [ *Details omitted. See note on page iv.* ]

3.69. Trow gave us details of the effects of these projects and of its acquisition of the BOCM Fish Feed Group on its production capacity. We have summarized them in Table 3.10.

TABLE 3.10 Trouw: feed capacity versus demand, six years to 2003

	tonnes					
	1998	1999	2000	2001	2002	2003
<i>Invergordon</i>						
Opening capacity						
De-bottlenecking						
<i>Longridge</i>						
Opening capacity						
Upgrade						
<i>Renfrew</i>						
Opening capacity						
Acquisition 1999						
Upgrade						
<i>Total</i>						
Opening capacity						
Renfrew acquisition						
Upgrades						
	<i>Figures omitted. See note on page iv.</i>					
<i>Less: forecast sales</i>						
Trout						
Fry						
Other						
Available for salmon feed						
Sales*						
Capacity surplus/(shortfall) (%)						

Source: Trouw.

\*For years 2000 to 2003 forecast sales from Table 3.8.

3.70. Trouw's capacity will be [ ] tonnes by the end of 2000 and will be [ ] tonnes a year later but, allowing for volumes for other species, it will not be fully utilized until [ ]. Trouw told us that the reasons for expanding its capacity now, and thus showing apparent free capacity in the short term, were:

- (a) The project at Renfrew gave these benefits :
  - (i) improvements in operational efficiency;
  - (ii) physical and specification consistency of the product with that from other Trouw manufacturing units; and
  - (iii) an increase in capacity.

Trouw could not obtain the first two improvements without the last.

- (b) There had been a change in working practices as result of the UK Working Time Regulations, which limit the average hours that can be worked in a week. This subsequently impacts on the amount of overtime that can be worked by any employee, hence limiting opportunities for working at weekends to make up production shortfalls. This would be covered by an increase in hourly productivity given by the increased capacity.

[ *Details omitted. See note on page iv.*

]

3.71. Trow said that estimating feed mill capacities was not an exact science and could be affected by product mix, seasonality (each fish species has a different seasonal demand for feed), plant performance, and the disruption caused by project work. For this reason there were some inconsistencies in the capacity data provided to us, which had been taken from estimates made at different times.

### *Profitability by customer*

3.72. Trow provided us with details of the sales value and margin per tonne for 1997 to 1999, and for the first eight months of 2000 (see Appendix 3.2) for six of its larger customers. [

*Details omitted. See note on page iv.*

]

3.73. Trow told us that all its major salmon feed contracts provided for price reviews every three or six months. A typical price review mechanism was based on a basket of raw materials, such as fishmeal, fish oil, cereals, vegetable proteins and pigment. The formula would reflect the typical average mix of the ingredients, and any price adjustment could be based on the movement of an average of spot prices and Nutreco's own bought position, or on the movement of spot prices only. Trow's pricing behaviour is described in paragraphs 4.179 to 4.185.

### *Marine Harvest*

3.74. The other UK acquisition by Nutreco in July 1999 was Booker Aquaculture Ltd trading as Marine Harvest McConnell. It had been the first company to enter salmon farming in Scotland. We were told that it was Unilever that put the first farmed salmon to sea in Scottish waters in 1968. It established a fish-farming company, Marine Harvest, and a fish feed business that marketed its products under the Fulmar brand. Salmon farming was slow to develop, but by the 1980s the industry was well established and production expanded rapidly. In 1989 the price of salmon and hence the margins of salmon farmers collapsed. In 1992 Unilever sold the Marine Harvest salmon-farming business to Marifarms Inc, a US company quoted on the AMEX stock exchange. This company subsequently renamed itself Marine Harvest International Inc (MHI). Hanson USA, a subsidiary of Hanson plc, owned 47 per cent of MHI. In the same year Unilever sold the Fulmar salmon feed business to BOCM, then a subsidiary of Harrisons & Crosfield plc.

3.75. In November 1994 Booker plc acquired MHI and directly transferred the ownership of Marine Harvest Ltd to Booker Belmont Wholesale Ltd (BBW), a wholly-owned subsidiary. BBW already owned another salmon farming business, McConnell Salmon Ltd, and on 31 December 1994 the entire operations of the two businesses were merged. In June 1995 Marine Harvest Ltd changed its name to Booker Aquaculture Ltd, adopting Marine Harvest McConnell (MHM) as its trading name.

3.76. The financial performance of MHM from 1 October 1994 to 31 December 1999, taken from its statutory accounts, is set out in Table 3.11. (The operations of Marine Harvest McConnell in Chile were managed by a separate subsidiary of Booker plc and, following the acquisition of the worldwide Marine Harvest business in July 1999, they have been held by another Nutreco subsidiary, so the table only shows the results of operations in Scotland.)

TABLE 3.11 MH: financial performance, 1 October 1994 to 31 December 1999

£'000

	52 weeks to 30.9.94	15 months to 30.12.95	52 weeks to 28.12.96	52 weeks to 27.12.97	65 weeks to 27.3.99	40 weeks to 31.12.99
Turnover	41,647	83,694	72,663	69,860	85,193	68,791
Cost of sales	<u>28,553</u>	<u>54,957</u>	<u>48,495</u>	<u>55,935</u>	<u>74,361</u>	<u>63,802</u>
Gross profit	13,094	28,737	24,168	13,925	10,832	4,989
Distribution costs	1,797	6,579	6,255	6,102	7,656	5,497
Administrative expenses	<u>4,870</u>	<u>10,612</u>	<u>8,135</u>	<u>8,175</u>	<u>9,755</u>	<u>6,407</u>
Operating profit/(loss)	<u>6,427</u>	<u>11,546</u>	<u>9,778</u>	<u>(352)</u>	<u>(6,579)</u>	<u>(6,915)</u>
Fixed assets (net)*	5,207	12,943	15,819	18,068	18,128	15,123
Ongoing fish	16,883	27,018	29,177	32,156	28,899	22,788
Other operating assets (net)	<u>(9,404)</u>	<u>(7,707)</u>	<u>(10,553)</u>	<u>(6,512)</u>	<u>(2,050)</u>	<u>(2,547)</u>
Net operating assets	<u>12,686</u>	<u>32,254</u>	<u>34,443</u>	<u>43,712</u>	<u>44,977</u>	<u>35,364</u>
Staff costs	7,717	14,758	11,619	12,515	17,216	10,525
Average employee numbers	423	566	660	692	734	874
						<i>per cent</i>
Ratios to turnover:						
Gross profit	31.4	34.3	33.3	19.9	12.7	7.3
Distribution costs	4.3	7.9	8.6	8.7	9.0	8.0
Administrative expenses	11.7	12.7	11.2	11.7	11.5	9.3
Operating profit/(loss)	15.4	13.8	13.5	(0.5)	(7.7)	(10.1)
Ratio to average operating assets:†						
Operating profit/(loss)	50.7	41.1	29.3	(0.9)	(11.9)	(22.4)
						<i>£ per employeet</i>
Turnover	98,456	147,870	110,095	100,954	92,853	102,321
Operating profit	15,194	16,319	14,815	(509)	(7,171)	(10,285)
Staff costs	18,243	20,859	17,605	18,085	18,764	15,655

Source: MH.

\*Excluding revaluations and an impairment adjustment of £18 million in 1998/99 reversed in the following period.

†Based on a 52-week period.

3.77. Table 3.11 shows the growth of the business in Scotland in 1995 following the merger of Unilever's Marine Harvest business with the McConnell salmon-farming operations. But profitability, as shown in terms of return on average operating assets, fell throughout the six financial periods from 50.7 per cent to minus 22.7 per cent a year. Nutreco told us that the decline in operating profit was caused by lower prices for salmon (aggravated by the strength of the pound sterling) which could not be matched by a reduction in costs, due to minimal investment and the effects of sea lice. Legislation on the use of medicines to control sea lice was less favourable than in Norway. However, production costs per unit had declined in all areas.

3.78. On 15 July 1999 Nutreco issued 1,038,576 new ordinary shares to Booker plc in exchange for the shares in the salmon activities of MHM in Scotland in settlement of a purchase consideration of £[ ] million. At that time Nutreco was expecting a deterioration in MHM's profits. In 1999 the threat of ISA had led to early harvesting at several sites. The smaller than average size of the fish harvested from these sites was depressing the average selling price for the year to the point where such sales were expected at best to be only marginally profitable. [

*Details omitted. See note on page iv.*

]

### Facilities

3.79. MH farms salmon from 38 seawater sites (including four contract rearing sites operated by three independent companies) and halibut from four seawater sites in Scotland (see Figure 3.1). Three of the salmon farms (at Ardnish, Grimshader and Waternishare) are used for broodstock. The active and fully-owned salmon sites have a capacity of [ ] tonnes under current SEPA consents. MH has four unutilized sites with a capacity of [ ] tonnes and four undeveloped sites with a capacity of [ ] tonnes.

3.80. MH has a hatchery at Inchmore and a smolt unit at Lochailort. There is also a development unit at Lochailort, which operates a halibut nursery and carries out research for MH and external clients. There are two primary processing plants: one in Blar Mhor, near Fort William, and one in Stornoway. The head office is in Craigerook Castle, Edinburgh. In addition to its own operations MH contracts some production of smolts and salmon to third parties. In the three years to 2000, between [ ] and [ ] per cent of smolt production was subcontracted, mostly at South Loch Shiel under a contract that has been running since 1977. In the same period [ ] to [ ] per cent of salmon production was subcontracted.

3.81. Nutreco told us that there was no fixed format for the contracts. Some growers could provide the entire infrastructure in terms of shorebase, cages, labour etc, while others could provide only the leases and consents. Generally the contracts featured a fixed monthly fee plus a bonus, either at the end or throughout the contract or indeed a profit share. MH would usually, though not always, supply the smolts and feed and the fish belonged to MH at all times. The financial risk of the exercise was essentially borne by MH since the monthly fee was fixed regardless of stock performance. Each contract was effectively renegotiated every two years (one cycle), although both parties would generally intend that it should run longer. In some cases contracts stopped because contractors decided they could get more money from another producer or from producing fish for themselves. Similarly there was no fixed size, with some contractors taking 60,000 fish and others over 1 million. Since the fish belonged to MH, there were no 'prices paid' per fish and the only payments were those indicated above.

### Feed purchases

3.82. Nutreco gave us details of MH's feed purchases in the three years to 1999 and its estimate for 2000 (based on the actual feed volume for the ten months to October, the feed on order for November and the estimated volume for December). These are set out in Table 3.12 and give an analysis by supplier.

TABLE 3.12 Deliveries of salmon feed to MH

	1997	1998	1999	2000*
	<i>tonnes</i>			
Trouw	<div style="display: flex; align-items: center; justify-content: center;"> <span style="font-size: 3em; margin-right: 10px;">{</span> <span style="font-size: 1.2em;">Figures omitted. See note on page iv.</span> <span style="font-size: 3em; margin-left: 10px;">}</span> </div>			
EWOS				
BioMar				
BOCM				
	<i>per cent</i>			
Trouw	<div style="display: flex; align-items: center; justify-content: center;"> <span style="font-size: 3em; margin-right: 10px;">{</span> <span style="font-size: 1.2em;">Figures omitted. See note on page iv.</span> <span style="font-size: 3em; margin-left: 10px;">}</span> </div>			
EWOS				
BioMar				
BOCM				

Source: Nutreco.

\*Tonnages for 2000 have been estimated by MH.

Table 3.12 shows that MH's main suppliers have been Trouw and EWOS. Between 1997 and 1999 EWOS's share of supply increased and in 1999 it supplied [ ] per cent of MH's salmon feed. Trouw has also been a large supplier of feed to MH over these four years, providing [ ] per cent of MH's requirements in 1997, falling to [ ] per cent in 1999. Following the acquisition of MH by Nutreco in 1999, Trouw almost doubled its share of MH's volume to [ ] per cent in 2000, while EWOS's share fell by more than half to [ ] per cent. During the four years shown in the table, neither BioMar nor BOCM were significant suppliers of salmon feed to MH.

### Investment plans

3.83. Nutreco told us that Booker had invested insufficient amounts in MH's facilities. MH's accounts show that fixed asset additions were £11.4 million in the two years 1996 and 1997, but fell to £8.4 million in 1998/99. This was a reduction of more than 25 per cent from a level that was already

inadequate. Nutreco told us that it had already invested £[ ] million and was committed to spending a further £[ ] million, about £[ ] million each year from 2000 to 2002, falling to about £[ ] million in 2003. Purchases would include the most modern automatic feeding systems and barges to ensure that MH could compete with the Norwegian industry.

### *Further mergers*

3.84. Nutreco told us that the salmon market in Scotland, as elsewhere, was undergoing rapid consolidation. There was a high level of interaction and discussion between most participants in the industry about the possibility for an acquisition, sale or merger. In common with other large industry players, Nutreco was regularly approached with various such proposals. In the last year it had acquired salmon farms at Loch Boisdale and Sconser where it had previously had contract growing arrangements.

### *Relations with Trouw*

3.85. Nutreco told us that MH and Trouw dealt with each other at arm's length, and that MH was permitted to buy its feed from other suppliers. If GSP were acquired, it would operate on the same basis.

## **The proposed merger**

### *The bidding process*

3.86. Norsk Hydro told us that in late 1996 it had drawn up a new business strategy and decided to focus on its core businesses of oil and energy, light metals and agri. Although the Hydro Seafood division was profitable, it was no longer seen as one of Norsk Hydro's core activities. It became publicly known in December 1998 that Norsk Hydro was seeking a new owner for the Hydro Seafood division. Norsk Hydro told us that it had disposed of several other non-core businesses since October 1999.

3.87. In October 1999 Norsk Hydro instructed the Norwegian branch of Enskilda Securities, a Swedish bank, to seek bids for the Hydro Seafood business. An information memorandum about the Hydro Seafood business was prepared, and was circulated to potential bidders chosen by Enskilda Securities. [ ] of them submitted indicative bids prior to the closing date of 20 December 1999.

3.88. Norsk Hydro then provided access to information, management presentations and plant visits to these [ ] bidders, after which they were required to submit binding bids prior to 17 February 2000. After this closing date Enskilda Securities and the leading bidders continued to have discussions. On 3 March 2000 Nutreco increased its bid and other interested parties were told that the final date for offers was 6 March 2000. Norsk Hydro and Nutreco then entered into an agreement of exclusive negotiation on 11 March 2000 (which was made public on 13 March 2000).

3.89. Norsk Hydro's expressed criteria for selection of the final buyer were:

- (a) to sell for the best commercial terms;
- (b) to ensure a good, industrial solution; and
- (c) [Details omitted. See note on page iv.].

### *Nutreco's bid for Hydro Seafood*

3.90. Nutreco told us that it had been interested in acquiring HSF. In August 1999 Norsk Hydro had already indicated that the HSF business was non-core, and Nutreco understood that it might have to submit a bid. On 1 September Nutreco representatives met Norsk Hydro management to be given an outline of the sales process and were invited to make an offer.

3.91. At this stage Nutreco prepared a paper for consideration by its supervisory board. [

*Details omitted. See note on page iv.*

]

3.92. Based on its preliminary projections, Nutreco made a conditional non-binding offer of NOK [ ~~8~~ ] billion in October, and qualified for the following round. It carried out a data room investigation and made visits to Hydro Seafood sites. Based on these the rationale and strategic importance of the acquisition remained valid and on 17 February 2000 it made an improved offer.

3.93. Nutreco asked a firm of corporate finance advisers to provide financial advice on its proposed acquisition of the Hydro Seafood business. In the letter that accompanied its report, this firm set out its interpretation of the reasons that Nutreco had given for the importance of Hydro Seafood to Nutreco:

[

*Details omitted. See note on page iv.*

]

3.94. On 3 March Nutreco was informed that, following the offer it had made on 17 February, Norsk Hydro had granted exclusivity until 31 March to negotiate the finalization of the acquisition. In its final presentation to the supervisory board it set out the rationale for the acquisition, including:

[

*Details omitted. See note on page iv.*

]



[

*Details omitted. See note on page iv.*

]

3.95. In the same presentation, supporting data showed that GSP would account for [ 38 ] per cent of Hydro Seafood's production of salmon in 2000, but this was forecast to increase to [ 38 ] per cent in 2002. Under the business plan GSP and Fanad were to be merged with MH. [

*Details omitted. See note on page iv.*

]

3.96. [

*Details omitted. See note on page iv.*

]

3.97. An appendix to the presentation document commented on potential scenarios arising from the market and industry developments that had been identified. [

*Details omitted. See note on page iv.*

] On the positive side, the acquisition of Hydro Seafood would make the majority of its feed account available to Nutreco when current contracts expired at the end of 2000.

3.98. On 4 April 2000 the supervisory board and the executive board approved the merger, and the share purchase agreement was signed on the same day.

### ***Share purchase agreement***

3.99. The share purchase agreement involves Norsk Hydro ASA and its two subsidiaries, Norsk Hydro (UK) Ltd and Norsk Hydro France, as sellers and Nutreco Holding NV as the buyer. The business is defined as the business of R&D, smolt breeding, farming and processing salmon in Norway, Scotland, Ireland and France and sale of such on a worldwide basis, carried on by the consolidated companies, and the minority interest companies. The consolidated companies include Hydro Seafood GSP Ltd and its subsidiaries (the Scottish Group). All of the minority interest companies are outside the UK.

3.100. The purchase price is € [ ] (about £[ ] million), made up as to € [ ] for the shares and € [ ] for the repayment of the intercompany loans as at [ ]. The amounts payable for the shares and the loans are:

	€'000		
	<i>Shares</i>	<i>Loans</i>	<i>Total</i>
HSF GSP Valmer	<div style="font-size: 3em; line-height: 1; padding: 0 10px;">(</div> <i>Figures omitted. See note on page iv.</i> <div style="font-size: 3em; line-height: 1; padding: 0 10px;">)</div>		

Fanad is a sub-subsidiary of HSF, and the amount attributed to the purchase price of HSF includes € [ ] for the Fanad shares and € [ ] for the Fanad loans. Allowing for this, [ ] per cent of the purchase consideration is attributable to the Norwegian business of Hydro Seafood, and [ ] per cent to its Scottish business. [ *Details omitted. See note on page iv.* ]

3.101. [ *Details omitted. See note on page iv.* ]  
 The buyer's obligation to purchase the shares is subject to the satisfaction of certain closing conditions (any of which may be waived by the buyer, in whole or in part), including the following:

any requisite filings with the European Commission, the UK Office of Fair Trading or any competent competition authority shall have been made; any required waiting periods under competition laws applicable to the transactions contemplated by this Agreement shall have expired; and neither the European Commission, the UK Office of Fair Trading nor any other competent competition authority shall have made any decision pursuant to which it would be illegal to consummate any of the transactions contemplated by this Agreement.

One effect of this condition is that the entire sale of the business, not just the Scottish group, has been delayed by our inquiry.

3.102. [ *Details omitted. See note on page iv.* ]

3.103. On 3 November 2000, Nutreco and Norsk Hydro informed us that Nutreco had sought the consent of the Secretary of State to acquire the shares in HSF, Valmer and Fanad, pending the outcome of our inquiry. The Secretary of State had given his consent in principle to this partial completion under section 75(4)(c) of the Act, subject to the agreement of certain assurances. These assurances had been secured on 25 October by the Director General of Fair Trading, and formal consent from the Secretary of State was awaited.

3.104. [ *Details omitted. See note on page iv.* ]

3.105. [ *Details omitted. See note on page iv.* ]

### *The BioMar agreement*

3.106. As part of the Share Purchase Agreement HSF (which will have become a subsidiary of Nutreco) is to enter into an agreement with BioMar, under which HSF will purchase specified volumes of feed products from BioMar in each of the three calendar years 2000 to 2002. The total annual volume for [ *Details omitted. See note on page iv.* ] Within the total annual volume about [  $\approx$  ] per cent is described as the [  $\approx$  ]. The contracted volumes in tonnes are:

<i>Year</i>	<i>Total</i>	( $\approx$ )
2000	[ <i>Figures omitted. See note on page iv.</i> ]	
2001		
2002		

In 2000 the [  $\approx$  ] represents less than [  $\approx$  ] per cent of the capacity of BioMar's factory in Grangemouth, which is stated to be [  $\approx$  ] tonnes (see paragraph 3.42).

3.107. The BioMar agreement states that if HSF wishes to order a total volume of feed products in any year to 2002 in excess of the total annual volumes set out in paragraph 3.106, BioMar shall use reasonable endeavours to accommodate such additional orders, and the terms of the agreement should equally apply to such supplies.

3.108. [

*Details omitted. See note on page iv.*

] The agreement is structured as a toll-milling agreement, with Nutreco retaining the right to supply the raw materials for incorporation in the feed products.

3.109. The parties told us that in the event of a partial completion, the BioMar agreement would enter into force only for the volumes allocated to the businesses acquired by Nutreco (see paragraph 3.106). Because of the delay in completion caused by our inquiry, the BioMar agreement would not come into force until near the end of 2000 and thus would only have just over two years to run, until 31 December 2002.

### ***Benefits of the merger***

3.110. Nutreco told us that Hydro Seafood was a non-core activity within Norsk Hydro. It would become a core activity within the Nutreco group. There would be benefits in terms of both management and financial investment. It considered that GSP, its employees and the localities within which it operated would benefit from the security of operation and increased investment that would result from this transaction. The merged entity would be in a good position to promote Scottish salmon in the international market and to increase export sales. The merger would help to ensure the sustainability of Scottish salmon farming within an increasingly global market. This would ensure continued employment and wealth in the rural areas where the businesses operated and where alternative employment was limited.

3.111. Nutreco stated that the environmental sustainability of the Scottish industry would benefit from the merger as a result of increased investment and the sharing of good practices. For example, the merger would enable the parties to improve management where both parties were operating within the same lochs and regions. The need for joint management of lochs had been identified in the ISA Code of Conduct as a means of preventing the spread of disease and improving fish health.

3.112. Nutreco told us that it was committed to ensuring the continued success of the Scottish farming industry and doing so in a way that would preserve the natural environment which was crucial to the

quality of the salmon produced. In response to our request for information on its investment plans, Nutreco pointed to its plans for investment in MH (see paragraph 3.83). Turning to its investment plans for GSP, Nutreco told us that, although a non-core business within Norsk Hydro, GSP was better equipped than MH had been when acquired from Booker. For the present the capital expenditure plans of GSP management had been taken at face value. In 2001 there would be £5.5 million of capital expenditure (to include an element of catching up after the ISA setback in recent years), falling to £3.2 million in 2002 and £1.9 million in 2003. However, like MH, it was not as well equipped as its Norwegian competitors, and it was likely that a further programme of investment similar to that for MH would be implemented, with similar benefits.

## **EWOS Ltd**

3.113. Apart from Nutreco and BioMar, there is a third large salmon feed company, EWOS. The company was first registered in Sweden in 1931 (its name is derived from the initials of its three founders) and was active in feed additives for the agricultural sector. In 1957 it began research into the manufacture of vitamin premixes for salmon fry, and over the next few years developed the first complete dry feed-pellets for salmon fry. In 1963 it began commercial production of salmon feed.

3.114. In 1970 EWOS was established in the UK as the first EWOS group company outside Scandinavia. At first EWOS imported salmon feed but, in 1982, it purchased the Westfield production site in Scotland from Edward Baker. In 1987 Cultor Oy, a Finnish company, acquired EWOS. By 1994 EWOS had sold all its agricultural feed businesses to focus solely on fish feed. In 1995 the EWOS Technology Centre was moved from Sweden to Livingstone, near Edinburgh, followed by the operational management centre in 1997. In 1998 EWOS International was formed within the EWOS group to manage the operations in Norway, Scotland and Canada.

3.115. In 1999 Cultor was acquired by Danisco, a Danish food company, which immediately declared EWOS to be a non-core business and effectively dismantled its management structure prior to divestment. Danisco sold the EWOS group to Statkorn Holding ASA (Statkorn) in April 2000. Statkorn had been wholly owned by the Norwegian state until December 1999, when 20 per cent of the shares were sold to about 40 private investors. Statkorn already owned 57 per cent of a smaller salmon feed business, NorAqua. NorAqua operated only in Norway, where it was the second largest supplier of fish feed after Nutreco's subsidiary, Skretting. EWOS told us that NorAqua's annual production was about 180,000 tonnes to EWOS's global 420,000 tonnes.

3.116. EWOS told us that economies of scale were important in the manufacture of salmon feed. The gain or loss of a 10,000 tonne contract would change the bottom line by £1 million. Before Nutreco's acquisition of MH and BOCM, EWOS's capacity utilization had been [ 80 ] per cent, but the loss of MH business had reduced it to [ 60 ] per cent. Since the end of 1996 its annual capacity had been [ 80 ] tonnes with five-day working, and [ 80 ] tonnes with seven-day working. An extruder unit had recently been replaced, but this had not led to an increase in capacity and there were no plans to increase it.

3.117. EWOS's financial performance is summarized in Table 3.13.

TABLE 3.13 EWOS: financial performance, seven years to 1999

	£'000						
	1993*	1994*	1995	1996	1997	1998	1999
Turnover	15,556	22,382	28,206	37,768	30,215	40,303	36,505
Cost of sales	<u>11,921</u>	<u>17,639</u>	<u>23,619</u>	<u>33,132</u>	<u>27,700</u>	<u>37,083</u>	<u>29,079</u>
Gross profit	3,635	4,743	4,587	4,636	2,515	3,220	7,426
Operating expenses	1,934	2,157	519	644	612	3,088	3,185
R&D	-	-	<u>2,420</u>	<u>2,630</u>	<u>3,043</u>	<u>2,380</u>	<u>1,988</u>
Operating profit	<u>1,701</u>	<u>2,586</u>	<u>1,648</u>	<u>1,362</u>	<u>(1,140)</u>	<u>(2,248)</u>	<u>2,253</u>
Net operating assets:							
Fixed assets (net)	2,280	4,768	7,499	7,660	9,124	9,794	8,415
Trade debtors	3,111	2,840	6,400	9,301	6,331	6,228	6,960
Other operating assets (net)	<u>(1,367)</u>	<u>(67)</u>	<u>(1,552)</u>	<u>(945)</u>	<u>(2,949)</u>	<u>(4,141)</u>	<u>(773)</u>
Year-end operating assets	<u>4,024</u>	<u>7,541</u>	<u>12,347</u>	<u>16,016</u>	<u>12,506</u>	<u>11,881</u>	<u>14,602</u>
							<i>per cent</i>
Average operating assets	4,024	5,783	9,944	14,182	14,261	12,194	13,242
Ratios to turnover:							
Gross profit	23.4	21.2	16.3	12.3	8.3	8.0	20.3
Operating expenses	12.4	9.6	1.8	1.7	2.0	7.7	8.7
R&D	-	-	8.6	7.0	10.1	5.9	5.4
Operating profit	10.9	11.6	5.8	3.6	(3.8)	(5.6)	6.2
Trade debtors	20.0	12.7	22.7	24.6	21.0	15.5	19.1
Ratio to average operating assets:							
Operating profit	42.3	44.7	16.6	9.6	(8.0)	(18.4)	17.0

Source: EWOS.

\*1993: 12 months to November; 1994: 13 months to December.

3.118. Table 3.13 shows fluctuations in EWOS's returns with its return on average net operating assets falling from more than 42 per cent in 1993 to a negative 18.4 per cent in 1998, before recovering in 1999. There are several elements in this:

- (a) Gross margins fell by almost two-thirds, from 23.4 per cent in 1993 to 8.0 per cent in 1998. EWOS told us that falling gross margins had been a direct consequence of a maturing market and a healthy competitive environment. The exceptionally low margin in 1998 was attributable to the impact of El Niño (see paragraph 4.184), and the resulting severe rise in raw material prices.
- (b) Net operating assets grew faster than turnover. Turnover in 1999 was about 2.3 times that in 1993, while net operating assets at the end of 1999 were over 3.6 times those in November 1993. About half the increase came in the first two years with a new extruder line and the development of the new technology centre in Livingstone.
- (c) The opening of the technology centre led to a large increase in expenditure on R&D until 1999, when the average number of R&D employees fell from 33 to 23.
- (d) The operating expenses of the trading business (that is excluding the R&D and technology centres) had, EWOS told us, been more stable than those shown in Table 3.13 and in the last two years had declined as a proportion of sales.

3.119. EWOS told us that its biggest customer was GSP, and its second biggest was MH. MH had been its largest customer, but following its acquisition by Nutreco an annual contract for 30,000 tonnes had not been renewed (see Table 3.12). Only when Nutreco became aware of its complaint to the OFT did MH give it a contract for 10,000 tonnes. At the same time GSP, which had not previously purchased significant amounts of feed from EWOS, gave it a contract for 15,000 tonnes (see Table 3.1). EWOS said that it did not expect to retain the MH business. If the acquisition of GSP went ahead, it seemed to EWOS fairly clear that it would lose both the MH and the GSP contracts.

3.120. In August 2000 EWOS announced that the Ministry of Agriculture in Norway had given a positive response to a proposal for an increase in Statkorn's capital of NOK 1.5 billion (more than £

100 million). This was to secure necessary resources for further acquisitions and expansion within aquaculture and to strengthen the capital base of EWOS. The proposed capital increase would require parliamentary approval. The Norwegian parliament had already decided that a further 29 per cent of Statkorn would be privatized and taken public when the time was right.

3.121. In July 2000 Statkorn acquired the remaining 43 per cent of NorAqua, and in August announced its first salmon-farming acquisition in Chile. At the same time it said that NorAqua and EWOS would be merged to form Statkorn Aqua, and that the merged entity would be managed from Livingstone.