

**COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA**

Case No: 32/LM/May02

In the large merger between:

Firstrand Bank Limited

and

Profurn Limited

Reasons

Approval

1. Further to the recommendation of the Competition Commission in terms of section 14A(1)(b), we approved the merger between Firstrand Bank Limited (Firstrand) and Profurn Limited (Profurn) on 29 May 2002.

The Transaction

2. The acquiring firm is Firstrand, a wholly-owned subsidiary of Firstrand Bank Holdings Limited. Profurn is the target firm.
3. This transaction was precipitated by a notice to Profurn from a consortium of bankers that have been providing finance to Profurn to reduce its overdraft facilities. Profurn was not in a position to do this out of its normal operating cash flow and faced the real prospect that if the banks refused to allow it to operate at the current level of borrowing, it will be unable to meet its obligations to creditors and would be forced to stop trading. After considering all options

available to it, the management of Profurn opted to raise an amount of R600 million to recapitalise the business by way of a rights offer to shareholders. Firstrand, the largest creditor of the consortium of banks, agreed to underwrite the rights offer and has bound itself to acquire the shares in circumstances where the shareholders of Profurn do not follow their rights¹.

4. According to the parties, even though it is Firstrand's stated preference that Profurn's shareholders follow their rights, this is unlikely to happen because of negative market sentiments towards credit granting retailers and Firstrand would probably acquire the bulk of these shares (and therefore control of Profurn) in terms of its underwriting commitments². Where, for example, none of the Profurn shareholders follow their rights, Firstrand will own 79% of the issued share capital of Profurn. It is this likelihood that the rights issue may result in a change of control in Profurn, with Firstrand becoming the majority shareholder, that the parties have decided to notify the transaction as a merger in terms of section 12 of the Act.
5. The parties claim that Firstrand, whose core business is in the financial sector, has no desire to control a furniture retail business and intends disposing of any interests acquired in Profurn as a result of this transaction as soon as market conditions allow. It is argued that it would not have been possible for Profurn to issue a rights offer that was not underwritten and Firstrand, already exposed to Profurn, was the only potential underwriter for a rights offer of the magnitude required to recapitalise the business.

Impact on Competition

6. There is no overlap between the businesses of the parties. Firstrand trades in the financial sector providing a variety of banking services such as retail, merchant, and corporate banking; short-term insurance, instalment finance etc. Profurn, on the other hand, is in the broad furniture retail business. It owns a number of branded stores focusing on a different income groups. Products sold in these stores include furniture, electric appliances, cellphones, home sound systems,

¹ Firstrand will receive an underwriting fee of R15 million, 2,5% of the required capital.

² Firstrand currently has no shareholding in Profurn.

televisions etc. Profurn trades mainly in South Africa but has stores in other African countries as well³. Because of the absence of product/service overlaps, this transaction is unlikely to lead to competition problems in any market.

7. However, we were advised by the parties that Firstrand is in the process of negotiating another underwriting agreement with Relyant Retail Limited (Relyant), a competitor of Profurn in the broad furniture retail market. These negotiations arose because the management of Relyant decided to undertake a major capital restructuring of the business. To achieve this it was decided that the business must raise an additional capital of over R791,5 million. The capital was to be raised by way of rights offer which would be underwritten by a consortium of four banks, including Firstrand, which were the principal debt providers to Relyant. It is envisaged that subsequent to the restructuring, and depending on the exact uptake of the rights issue, the banks collectively will hold 49.9% of the issued share capital in Relyant. Firstrand on its own may hold 24% of the shares in Relyant, making it the biggest shareholder amongst the banks. POCO Holding GmbH, a strategic retail investor from Germany, brought in to facilitate the restructuring process, will have the biggest stake with a shareholding of at least 35%.⁴
8. We were concerned about the potential effect of this transaction on competition in the broad furniture retail market. Profurn and Relyant are two of three biggest competitors in this market⁵ and the possibility that the majority shareholder in the one company could also become the second biggest shareholder in the other is obviously disconcerting for a competition authority. We therefore requested the parties for more information on the Relyant transaction. According to Firstrand, the terms of the underwriting agreement between itself and Relyant have not yet been finalized. We were informed that if Firstrand does acquire the shareholding in Relyant it would be by default; they have no intention of holding equity in Relyant. Firstrand sees this transaction as a rescue operation and has agreed to convert a large portion of their debt funding into equity only to help recapitalise

³ Profurn's component of turnover from outside South Africa currently stands at approximately 38%.

⁴ POCO was introduced to Relyant by FNB Corporate, a division of Firstrand.

⁵ According to the parties' estimates, the three biggest shareholders in this market are the JD Group (16%), Profurn (12%) and Relyant (9%).

Relyant, to which it is already exposed. To support this claim, it is claimed that the banks, who will have rights to appoint directors in proportion to their shareholding, have no intention of doing so at this stage and may consider doing so only where this becomes necessary to protect their investment.

9. Firstrand claims that even though it may appoint board members, it will never have control of Relyant. It states that it has made it clear to POCO, which is likely to be the largest shareholder, that they do not intend holding equity in the furniture retail market and will be disposing of their equity holdings over the next five years.
10. To allay our concerns, Firstrand volunteered an undertaking to “notify the Competition Commission, should there be a change of control as contemplated by the Competition Act, as a result of the recapitalisation of Relyant”. Firstrand also informed us that in any event, Relyant’s advisors, INVESTEC, have advised them that it was their intention to submit the Relyant transaction for consideration by the competition authorities upon finalisation.
11. The merger between Firstrand and Profurn raises no competition concerns since there is no overlap between the products/services of the merging parties. With regard to the transaction being negotiated between Firstrand and Relyant, assuming Firstrand still controls Profurn pursuant to this merger and the Relyant transaction leads to a change of control, a product/services overlap will result and the transaction may require very close competition scrutiny. In light of the commitments referred to in paragraph 10 above, and the fact that the transaction has not been finalized (and there is no guarantee that the transaction will occur at all), it is prudent that any impact the transaction may have on competition be evaluated at the time of notification when all the terms of the agreement are known.

Public Interest issues

12. It is not envisaged that any job losses will result directly from the merger. According to the parties, Profurn has retrenched about 800 employees because of the current financial situation of the company. The decision to embark on this retrenchment process was taken last

year and has no connection to the merger. The parties claim this process has in fact been completed.

13. No other public interest issues arise from this transaction.

Conclusion

14. The Tribunal endorses the Commission's finding that this transaction is not likely to substantially lessen or prevent competition in the market and accordingly approves the transaction without conditions.

N.M. Manoim

04 June 2002
Date

Concurring: D.H. Lewis, U. Bhoola