

## 2 The companies and the merger situation

2.1. Both companies involved in this transaction are extensive in resources and international in scope, one having its headquarters in the United States and the other in the United Kingdom. Both make and sell branded consumer goods and each owns several 'household names'. The transfer from one to the other of part of its business in applied shoe care products had been completed before this reference was made.

### **Sara Lee Corporation**

2.2. Sara Lee is a multinational company with headquarters in Chicago. It has operations in over 30 countries and employs more than 110,000 people world-wide. It was previously known as Consolidated Foods Corporation, the change of name in 1985 recognising the stronger appeal of a name that was not generic.

2.3. Its products fall into four divisions: packaged meats and bakery; personal products, including hosiery, knitwear, underwear and clothing accessories; coffee and grocery; and household and personal care products, including toiletries, air fresheners, insecticides, cleaning products and shoe care.

2.4. Sara Lee's activities in the United Kingdom comprise the manufacture of toiletries, cosmetics and household products, frozen bakery products, and ladies' hosiery and underwear; the distribution of coffee, tea and juices; and the distribution and retail sale of fashion accessories, knitwear and sportswear. In the United Kingdom Sara Lee's household and personal care businesses are carried on by Sara Lee Household and Personal Care UK Ltd (SL/HPC UK), which is indirectly a subsidiary of Sara Lee and which reports to another Sara Lee subsidiary, Sara Lee/DE NV (SL/DE), in the Netherlands. The legal and management structures are summarised at Appendices 2.1 and 2.2 respectively.

### **Shoe care**

2.5. Sara Lee had no shoe care interests in the United Kingdom until 1984, when it acquired Nicholas Kiwi, an Australian public company which had been formed three years previously as the result of a merger between two long-established Australian companies, Nicholas International, whose business was mainly in pharmaceuticals and toiletries, and the Kiwi Polish Company whose business was mainly in household products and included Kiwi shoe polish. In 1991 its pharmaceuticals business world-wide (including the United Kingdom business operated by Nicholas Laboratories Ltd (Nicholas Laboratories)) was sold for some \$800 million to the Hoffmann-La Roche group, the household and toiletries businesses being retained by Sara Lee.

2.6. Sara Lee markets shoe care products in over 110 countries, either directly or through licensees or distributors. It has shoe care manufacturing companies in the United States; in Europe (Belgium, France, Italy, Monaco, Spain and the United Kingdom); Australia; Africa (Kenya, Malawi and Zimbabwe); and in South-East Asia (Indonesia, Malaysia, the Philippines, Taiwan, Thailand and Singapore).

2.7. The United Kingdom factory at Honley, near Huddersfield, which we visited, has facilities for the manufacture of pastes, creams and liquid polishes. There is also a warehouse and distribution centre at Lutterworth, Leicestershire, and the United Kingdom administrative, financial and sales headquarters of that part of the group that handles shoe care are at Slough.

## Financial information

2.8. Sara Lee prepares its accounts for periods of 52 or 53 weeks ending on the Saturday nearest to 30 June each year. In the year ended 29 June 1991 it made a profit before tax of \$830 million on a turnover of \$12,381 million, with capital employed at the year-end of \$5,843 million. (The average rate of exchange in the year was around \$1.86 to the £.)

2.9. Table 2.1 summarises Sara Lee's consolidated profit and loss accounts for the last five years.

TABLE 2.1 Sara Lee: summarised profit and loss accounts

	\$ million				
	1986/87	1987/88	1988/89	1989/90	
1990/91					
Net sales	9,155	10,424	11,718	11,606	12,381
Cost of sales	-6,310	-7,097	-8,040	-7,755	-8,072
Selling, general and administrative expenses	<u>-2,329</u>	<u>-2,718</u>	<u>-2,936</u>	<u>-2,992</u>	<u>-3,359</u>
Profit before interest and unusual items	516	609	741	859	950
Interest (net)	-68	-96	-133	-146	-120
Unusual items (net)	-	-	<u>31</u>	-	-
Profit before tax	448	513	639	713	830
Tax	<u>-181</u>	<u>-188</u>	<u>-229</u>	<u>-243</u>	<u>-295</u>
Profit after tax	<u>267</u>	<u>325</u>	<u>410</u>	<u>470</u>	<u>535</u>
					per cent
Trading margin (pre-tax profit/net sales)	4.9	4.9	5.5	6.1	6.7

Source: MMC using Sara Lee data.

2.10. A segmental analysis of Sara Lee's sales and pre-tax profit for its last two accounting periods is given in Table 2.2. Shoe care forms part of the household and personal care division.

TABLE 2.2 Sara Lee: segmental sales and profit

	\$ million					
	1989/90			1990/91		
	Sales	Pre-tax profit	%	Sales	Pre-tax profit	%
Packaged meats and bakery	4,959	208	4.2	5,124	229	4.5
Coffee and grocery	1,833	199	10.9	1,938	245	12.6
Personal products	3,757	424	11.3	4,104	484	11.8
Household and personal care	<u>1,060</u>	<u>107</u>	10.1	<u>1,215</u>	<u>128</u>	10.5
	11,609	938	8.1	12,381	1,086	8.8
Inter-segmental sales	-3	-		-	-	
Corporate expenses	-	<u>-225</u>		-	<u>-256</u>	
	11,606	713	6.1	12,381	830	6.7

Source: MMC using Sara Lee data.

2.11. Table 2.3 analyses Sara Lee's balance sheet positions at its last five year-ends. Sara Lee is a 'brands' business and trade marks and other intangible assets account for a substantial part of its capital employed and net assets. If intangibles are treated as part of shareholders' funds, capital gearing has not been exceptionally high over most of the last five years, having fluctuated between 42 and 80 per cent.

TABLE 2.3 Sara Lee: balance sheet positions

	\$ million				
	30 June				
	1987	1988	1989	1990	1991
Trade marks and other intangible assets	874	1,418	2,061	2,433	2,703
Tangible fixed assets	1,241	1,416	1,773	2,204	2,389
Investments in associated companies	116	89	189	131	110
Other net assets (excluding net borrowings)	<u>360</u>	<u>224</u>	<u>417</u>	<u>559</u>	<u>641</u>
Capital employed	2,591	3,147	4,440	5,327	5,843
Net borrowings	-627	-835	-1,681	-1,697	-1,647
Provisions for deferred tax and other liabilities	<u>-473</u>	<u>-507</u>	<u>-650</u>	<u>-743</u>	<u>-955</u>
Net assets	<u>1,491</u>	<u>1,805</u>	<u>2,109</u>	<u>2,887</u>	<u>3,241</u>
Minority interests		5	12	257	347
Preferred stock	75	225	182	338	344
Common stockholders' equity	<u>1,416</u>	<u>1,575</u>	<u>1,915</u>	<u>2,292</u>	<u>2,550</u>
Shareholders' funds (including minorities)	<u>1,491</u>	<u>1,805</u>	<u>2,109</u>	<u>2,887</u>	<u>3,241</u>
				<i>per cent</i>	
Capital gearing (net borrowings/shareholders' funds including intangibles)	42	46	80	59	51

Source: MMC using Sara Lee data.

Note: Net borrowings consist of long-term debt (including current maturities) and notes payable, less cash and equivalents.

2.12. Sara Lee's returns on average capital employed for its last four accounting periods are shown in Table 2.4. These have ranged between 17 and 21 per cent if intangible assets are treated as part of capital employed.

TABLE 2.4 Sara Lee: returns on average capital employed

	1987/88	1988/89	1989/90	1990/91
Profit before interest (\$m)	609	741	859	950
Average capital employed including intangibles (\$m)	2,869	3,793	4,884	5,585
Return on average capital employed including intangibles (%)	21	20	18	17

Source: MMC using Sara Lee data.

Note: Average capital employed for each year has been calculated by taking simple averages of the opening and closing amounts.

## European operations

2.13. Sara Lee's United Kingdom shoe care business reports to SL/DE which is principally the management company for Sara Lee's coffee and grocery and the household and personal care divisions.

2.14. SL/DE prepares its accounts to 30 June each year. In the year ended 30 June 1991 it made a profit before tax and extraordinary items of Dfl 647 million on a net turnover of Dfl 5,652 million, with capital employed at the year-end of Dfl 1,638 million. (The average rate of exchange during that year was around Dfl 3.3 to the £.)

2.15. Table 2.5 summarises SL/DE's consolidated profit and loss accounts for the last three years.

TABLE 2.5 **SL/DE: summarised profit and loss accounts**

	<i>Dfl million</i>		
	1988/89	1989/90	1990/91
Net sales	5,413	5,411	5,652
Cost of sales	-3,372	-3,165	-3,220
Selling, general and administrative expenses	<u>-1,512</u>	<u>-1,620</u>	<u>-1,767</u>
Operating profit	530	626	665
Interest (net)	-99	-94	-26
Results of related companies <sup>2</sup>	1	4	
Foreign currency results	<u>12</u>	<u>-6</u>	<u>5</u>
Profit before tax	445	527	648
Tax	-135	-141	-182
Extraordinary items	21	2	-
Minority interests	<u>-1</u>	<u>-2</u>	<u>-4</u>
Profit after tax	<u>330</u>	<u>386</u>	<u>462</u>
			<i>per cent</i>
Trading margin (pre-tax income/net sales)	8.2	9.7	11.5

Source: MMC using SL/DE data.

2.16. Table 2.6 analyses SL/DE balance sheet positions at its last three year-ends. Although capital gearing was high at 30 June 1989, it had fallen by 30 June 1991, reflecting a substantial reduction in net borrowings.

TABLE 2.6 **SL/DE: balance sheet positions**

	<i>Dfl million</i>		
	30 June		
	1989	1990	1991
Intangible fixed assets	110	97	65
Tangible fixed assets	992	989	1,168
Financial fixed assets	39	35	27
Other net assets (excluding net borrowings)	<u>515</u>	<u>257</u>	<u>378</u>
Capital employed	1,656	1,378	1,638
Net borrowings	-928	-200	-60
Provisions for deferred tax and other liabilities	<u>-456</u>	<u>-419</u>	<u>-390</u>
Net assets	<u>272</u>	<u>759</u>	<u>1,188</u>
Minority interests	16	2	93
Share capital and reserves	<u>256</u>	<u>759</u>	<u>1,095</u>
Shareholders' funds (including minorities)	<u>272</u>	<u>759</u>	<u>1,188</u>
			<i>per cent</i>
Capital gearing (net borrowings/shareholders' funds including intangibles)	341	26	5

Source: MMC using SL/DE data.

Note: Net borrowings consist of subordinated loans, loans from participants, bank loans and overdrafts and notes payable, less liquid assets.

2.17. SL/DE's returns on average capital employed for the last two years are shown in Table 2.7.

TABLE 2.7 **SL/DE: returns on average capital employed**

	1988/89	1989/90
Profit before interest (Dfl million)	626	665
Average capital employed including intangibles (Dfl million)	1,517	1,508
Return on average capital employed including intangibles (%)	41	44

Source: MMC using SL/DE data.

## The United Kingdom shoe care business

2.18. Nicholas Laboratories was the operating company for Sara Lee's household and personal care activities in the United Kingdom until 1991. On 27 May 1991 its business, together with certain assets subsequently sold, was transferred to its immediate holding company, then called Aspro-Nicholas plc, in preparation for the sale of Nicholas Laboratories to the Hoffmann-La Roche group as part of Sara Lee's disposal of its world-wide pharmaceutical business. The results of trading for the 11 months to 27 May 1991 are contained in the Nicholas Laboratories accounts and those for June 1991 in the accounts of Aspro-Nicholas plc, which subsequently changed its name to Sara Lee Household & Personal Care UK Ltd.

2.19. The profit and loss accounts of Nicholas Laboratories for the years 1986/87 to 1990/91 and of SL/HPC UK (formerly Aspro-Nicholas plc) for 1990/91 are summarised in Table 2.8.

TABLE 2.8 Nicholas Laboratories and SL/HPC UK: summarised profit and loss accounts

*£ million*

	Nicholas Laboratories					SL/HPC UK
	1986/87	1987/88	1988/89	1989/90	1990/91*	1990/91†
Turnover	48.6	52.3	52.6	54.0	48.7	12.4‡
Cost of sales	<u>-21.8</u>	<u>-24.5</u>	<u>-24.5</u>	<u>-23.9</u>	<u>-22.4</u>	<u>-3.1</u>
Gross profit	26.8	27.8	28.1	30.1	26.3	9.3
Other operating expenses	<u>-23.2</u>	<u>-24.5</u>	<u>-23.6</u>	<u>-27.6</u>	<u>-24.7</u>	<u>-3.6</u>
Operating profit	3.6	3.3	4.5	2.5	1.6	5.7
Investment income less						
interest payable	<u>-</u>	<u>0.1</u>	<u>-1.1</u>	<u>-1.4</u>	<u>0.1</u>	<u>8.0</u>
Profit before tax	3.6	3.4	3.4	1.1	1.7	13.7
Tax	<u>-0.7</u>	<u>-2.5</u>	<u>-1.3</u>	<u>-0.6</u>	<u>0.1</u>	<u>-2.3</u>
Profit after tax	2.9	0.9	2.1	0.5	1.8	11.4

Source: MMC using Sara Lee data.

\*Includes trading results to 27 May 1991.

†Covers trading for June 1991.

‡Royalties £4.9 million and manufacturing turnover £7.5 million.

2.20. Table 2.9 analyses the balance sheet positions of Nicholas Laboratories at its last five year-ends, and also that of SL/HPC UK at 30 June 1991.

TABLE 2.9 Nicholas Laboratories and SL/HPC UK: balance sheet positions, 30 June

*£ million*

	Nicholas Laboratories					SL/HPC UK
	1987	1988	1989	1990	1991	1991
Intangible assets	1.6	1.6	1.5	1.5	-	1.4
Tangible fixed assets	13.6	13.7	26.8	28.5	1.3	32.8
Fixed asset investments	2.2	1.5	1.5	1.5	0.8	9.7
Other net assets (excluding cash/borrowings)	<u>10.5</u>	<u>3.8</u>	<u>24.9</u>	<u>33.3</u>	<u>-</u>	<u>42.9</u>
Net cash/borrowings	2.7	-1.4	-0.3	5.7	-	86.8
	2.8					
Net indebtedness to associated and subsidiary companies	-16.9	-13.2	-19.3	-34.9	-0.8	-14.6
Provisions for liabilities and charges	<u>-1.2</u>	<u>-1.1</u>	<u>-7.2</u>	<u>-7.2</u>	<u>-</u>	<u>-7.2</u>
Capital and reserves	12.5	4.9	27.9	28.4	1.367.8	

Source: MMC using Sara Lee data.

2.21. Sara Lee provided us with information on the sales and profits of its United Kingdom applied shoe care products business. In Table 2.10 we show sales by product categories for the periods of 11 months to 31 May 1991 and 1992 respectively; the latter period includes Reckitt & Colman products from October 1991.

TABLE 2.10 Sales of applied shoe care products

	<i>£'000</i>	
	<i>11 months to 31 May 1991</i>	<i>1992</i>
Kiwi paste polish	1,535	1,474
Convenience	318	310
Elite	321	345
Heel renew pens	100	57
All protector	57	51
Rich shoe cream	259	205
Sport	144	266
Tuxan polish	192	206
Other Kiwi	94	85
Cherry Blossom	-	696
Padawax	-	160
Meltonian	-	542
Properts	-	46
Other ex-Reckitt & Colman	-	624
Magix	-	47
Private label	94	168
Export	<u>-</u>	<u>969</u>
	3,114	6,251

Source: Sara Lee.

2.22. In Table 2.11 we show Sara Lee's profits on its United Kingdom applied shoe care products business for the year to 30 June 1991 and the half year to 31 December 1991. We also asked Sara Lee for a statement of its profits to the latest available date in 1992 but it told us that it was unable to comply with this request as it did not calculate profit for parts of the business except on a six-monthly basis.

TABLE 2.11 Profits of applied shoe care products

	<i>£'000</i>	
	<i>Year to 30 June 1991</i>	<i>Half year to 31 December 1991</i>
Sales	3,366	-
Discounts	<u>-116</u>	-
Net sales	3,250	2,733
Prime costs	-1,609	-1,500
Factory overheads	<u>-162</u>	-180
Gross profit	1,479	1,053
Carriage to customers	[	
Central warehouse costs		
Advertising and promotion		<i>Figures omitted.</i>
Marketing		<i>See note on</i>
Selling		<i>page iv.</i>
Administration		
Operating profit		]
		<i>per cent</i>
Ratios:		
Gross profit/sales	[	<i>Figures omitted.</i>
Operating profit/sales		<i>See note on page iv.</i> ]

Source: Sara Lee.

Note: The fall in advertising and promotion in the half-year to 31 December 1991 was due to the timing of expenditure.

## Reckitt & Colman plc

2.23. Reckitt & Colman is an international group with headquarters in London engaged in the manufacturing and marketing of branded consumer goods falling into three main product groups: household and toiletry, food, and pharmaceuticals. It developed from three family businesses which began operations in Britain in the 19th century, and now its products are manufactured in over 30 countries and sold (principally through supermarket and pharmacy outlets) in over 120.

### Shoe care

2.24. Reckitt & Colman's shoe care business originated in 1954 when Chiswick Products became part of the group. Chiswick Products included such well-known names in shoe care as Cherry Blossom, Meltonian and Wren's, formerly owned by independent companies.

2.25. Reckitt & Colman restructured its shoe care business as a separate unit, the Shoe Care Division, as part of its household and toiletry product group at the beginning of 1990 with the intention of generating improved growth, greater efficiency, and an acceptable level of profitability. This division was wound up following the disposal to Sara Lee. Reckitt & Colman does, however, retain a substantial shoe care business in many countries of Asia, Africa and Latin America, as well as in some European countries, where products are sold principally under one or other of the brand names Nugget, Cherry or Cherry Blossom, and Griffin, the last-named being a mass-market brand in the United States which was acquired as a part of the Boyle-Midway acquisition to which reference is made in paragraph 2.30.

### Financial information

2.26. Reckitt & Colman prepares its accounts for 52 or 53 weeks ending on the Saturday nearest to the end of December each year. In 1991 it made a profit before tax of £252 million on a turnover of £1,987 million, with capital employed at the year-end of £1,137 million.

2.27. Table 2.12 summarises Reckitt & Colman's consolidated profit and loss accounts for the last five years.

TABLE 2.12 Reckitt & Colman: summarised profit and loss accounts

	<i>£ million</i>				
	1987	1988	1989	1990	1991
Sales	1,492	1,394	1,566	1,764	1,987
Cost of sales	<u>-828</u>	<u>-750</u>	<u>-820</u>	<u>-905</u>	<u>-983</u>
Gross profit	664	644	746	859	1,004
Distribution costs	-386	-362	-441	-513	-615
Administrative expenses	-105	-91	-91	-108	-117
Other operating income	<u>7</u>	<u>7</u>	<u>6</u>	<u>15</u>	<u>21</u>
Trading profit	180	198	220	253	293
Interest payable less other income	<u>-13</u>	<u>-7</u>	<u>-3</u>	<u>-18</u>	<u>-41</u>
Profit before tax	167	191	217	235	252
Tax	<u>-64</u>	<u>-69</u>	<u>-76</u>	<u>-77</u>	<u>-82</u>
Profit after tax	103	122	141	158	170
Minority interests	-2	-2	-1	-1	-1
Coupon on convertible capital bonds	-	-	-	-5	-13
Extraordinary items	16	8	-17	-21	-15
Dividends	<u>-32</u>	<u>-38</u>	<u>-44</u>	<u>-51</u>	<u>-56</u>
Retained profit	<u>85</u>	<u>90</u>	<u>79</u>	<u>80</u>	<u>85</u>
				<i>per cent</i>	
Trading margin (pre-tax profit/net sales)	11.2	13.7	13.9	13.3	12.7

Source: MMC using Reckitt & Colman data.

2.28. A segmental analysis of Reckitt & Colman's sales, pre-tax profits and capital employed for the last two years, analysed by area and by product group, is given in Table 2.13. As noted in paragraph 2.25, shoe care formed part of the household and toiletry product group.

TABLE 2.13 **Reckitt & Colman: segmental sales and profits**

Capital	1990					1991				
	Sales	Capital employed	Trading profit	Return on Sales	Return on Capital	Sales	Capital employed	Trading profit	Return on Sales	Return on Capital
	£m	£m	£m	%	%	£m	£m	£m	%	%
<i>By area</i>										
United Kingdom	364	135	62	17.0	45.9	365	116	69	18.9	59.5
Rest of Europe 442	261	53	12.0	20.3	509	278	79	15.5	28.4	
North America 473	473	50	10.6	10.6	597	547	54	9.0	9.9	
Australasia and Asia	196	86	40	20.4	46.5	211	78	42	19.9	53.8
Africa	109	30	20	18.3	66.6	114	30	21	18.4	70.0
Latin America	<u>180</u>	<u>68</u>	<u>28</u>	15.6	41.2	<u>191</u>	<u>74</u>	<u>28</u>	14.7	37.8
	<u>1,764</u>	1,053	<u>253</u>	14.3	24.0	<u>1,987</u>	1,123	<u>293</u>	14.7	26.1
Provisions for liabilities and charges		104					71			
Ordinary dividends		<u>-51</u>					<u>-57</u>			
		<u>1,106</u>					<u>1,137</u>			
<i>By product group</i>										
Household and toiletry	1,023	825	146	14.3	17.7	1,248	890	187	15.0	21.0
Food	505	156	54	10.7	34.6	517	171	57	11.0	33.3
Pharmaceutical	156	45	40	25.6	88.9	168	34	40	23.8	117.6
Other activities	<u>80</u>	<u>27</u>	<u>13</u>	16.3	48.1	<u>54</u>	<u>28</u>	<u>9</u>	16.7	32.1
	<u>1,764</u>	1,053	<u>253</u>	14.3	24.0	<u>1,987</u>	1,123	<u>293</u>	14.7	26.1
Provisions for liabilities and charges		104					71			
Ordinary dividends		<u>-51</u>					<u>-57</u>			
		<u>1,106</u>					<u>1,137</u>			

Source: MMC using Reckitt & Colman data.

2.29. Table 2.14 analyses Reckitt & Colman's balance sheet positions at the end of each of the last five years.

TABLE 2.14 **Reckitt & Colman: summarised balance sheets**

1991	End December				£ million
	1987	1988	1989	1990	
Intangible assets (trade marks)	127	135	163	573	587
Tangible fixed assets	307	328	376	407	398
Investments in associated companies	4	4	6	5	5
Other net assets (excluding net borrowings)	<u>125</u>	<u>98</u>	<u>129</u>	<u>121</u>	<u>147</u>
Capital employed	563	565	674	1,106	1,137
Net borrowings	-51	-2	-19	-358	-338
Provisions for liabilities and charges	<u>-31</u>	<u>-34</u>	<u>-54</u>	<u>-104</u>	<u>-71</u>
Net assets	<u>481</u>	<u>529</u>	<u>601</u>	<u>644</u>	<u>728</u>
Minority interests	9	9	9	8	8
Share capital and reserves	472	520	592	435	519
Convertible capital bonds	-	-	-	201	201
Shareholders' funds (including minorities)	<u>481</u>	<u>529</u>	<u>601</u>	<u>644</u>	<u>728</u>
					<i>per cent</i>
Capital gearing (net borrowings/shareholders' funds including intangibles)	11	-	3	56	46

Source: MMC using Reckitt & Colman data.

Note: Net borrowings consist of loans and overdrafts, less cash and current asset investments.

2.30. During 1990 Reckitt & Colman made acquisitions costing £746 million, of which £185 million goodwill was written off to reserves and £455 million trade marks was added to the intangible asset account in the balance sheet. The principal acquisition was the Boyle-Midway household products and depilatory business which cost £713 million (including £25 million paid in 1991). Largely as a result of this acquisition intangible assets increased from £163 million at the end of 1989 to £573 million at the end of 1990. The financing of the acquisition also caused net borrowings to increase from £19 million at the end of 1989 to £358 million at the end of 1990. During 1991 borrowing fell to £338 million.

2.31. It will be seen that capital gearing was 56 per cent at the end of 1990 and 46 per cent at the end of 1991 if the book value of the intangible assets (trade marks) is treated as part of shareholders' funds and if the £201 million 9.5 per cent convertible capital bonds 2005 issued in 1990 are regarded as part of Reckitt & Colman's equity. The holders of these bonds may convert to ordinary shares on 31 July in each of the years 1993 to 2004 and on the maturity date. There is no put option under which bond holders can require the bonds to be redeemed. Reckitt & Colman considers that the bonds will become part of its share capital and has dealt with them in its balance sheet accordingly.

2.32. Reckitt & Colman's returns on average capital employed for its last four years are shown in Table 2.15. These ranged between 26 and 35 per cent if intangible assets are treated as part of capital employed.

TABLE 2.15 Reckitt & Colman: returns on average capital employed

	<i>£ million</i>			
	1988	1989	1990	1991
Trading profit	198	220	253	293
Average capital employed including intangibles (£m)	564	620	890	1,122
Return on average capital employed including intangibles (%)	35	35	28	26

Source: MMC using Reckitt & Colman data.

Note: Average capital employed for each year has been calculated by taking simple averages of the opening and closing amounts.

## The United Kingdom shoe care business

2.33. Reckitt & Colman Products Ltd and Reckitt & Colman (Overseas) Ltd were the Reckitt & Colman companies which dealt in applied shoe care products in the United Kingdom. Summaries of their profit and loss accounts for 1989 and 1990 are given in Table 2.16.

TABLE 2.16 Reckitt & Colman: summaries of profit and loss accounts of Reckitt & Colman Products Ltd and Reckitt & Colman (Overseas) Ltd

	<i>Reckitt &amp; Colman Products Ltd</i>		<i>Reckitt &amp; Colman (Overseas) Ltd</i>	
	1989	1990	1989	1990
Turnover	294	315	42	41
Cost of sales	<u>-178</u>	<u>-198</u>	<u>-24</u>	<u>-25</u>
Gross profit	116	117	18	16
Distribution costs	-67	-62	-8	-9
Administrative expenses	-15	-22	-4	-5
Other operating income	<u>4</u>	<u>1</u>	<u>5</u>	<u>5</u>
Trading profit	38	34	11	7
Interest receivable less payable	<u>9</u>	<u>7</u>	<u>-</u>	<u>-3</u>
Profit before tax	47	41	11	4
Tax	<u>-16</u>	<u>-16</u>	<u>-4</u>	<u>-2</u>
Profit after tax	31	25	7	2
Extraordinary items	<u>-6</u>	<u>-16</u>	<u>2</u>	<u>-</u>
Profit available for dividends	25	9	9	2

Source: MMC using Reckitt & Colman data.

2.34. In Table 2.17 we show the results of Reckitt & Colman's United Kingdom shoe care operations for 1990 and for the period to 4 October 1991 when the business was sold to Sara Lee.

TABLE 2.17 **Reckitt & Colman: results of United Kingdom shoe care operations**

	£'000	
	1990	1991 (to 4 October)
Gross sales	6,618	5,705
Deductible merchandising	<u>-1,362</u>	<u>-1,287</u>
Sales to customers	<u>5,256</u>	<u>4,418</u>
Contribution before marketing	2,279	1,904
Marketing - consumer	-319	-304
- trade	<u>-326</u>	<u>-196</u>
Contribution after marketing	1,634	1,404
Overhead costs	[	
Exceptional and other items		
Intra-group royalties and fees		<i>Figures omitted.</i>
Interest to third parties less other income		<i>See note on page iv.</i>
Profit/loss before tax		
Tax		
Profit/loss after tax		]

Source: MMC using Reckitt & Colman data.

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*Note:* Reckitt & Colman told us that no allowance is made for central group overheads in the above table, but that the amounts involved were not material.

Appendix 2.3 analyses sales and contribution before marketing for each of the above periods between categories of product and between home (grocery and specialist) and export sales.

## The acquisition

2.35. Sara Lee's original interest, made known informally to Reckitt & Colman in 1990, was in acquiring the Meltonian brand world-wide, because this would have given a degree of access to the special trades (see Chapter 3 for a description of market sectors) in which the company felt it lacked an effective presence. Reckitt & Colman countered with the suggestion that it might be prepared to sell all its United Kingdom and United States shoe care operations, which were based on its factory at Hull, while retaining its other world-wide shoe care interests which were managed autonomously on a local basis. The reasons for Reckitt & Colman's willingness to sell, and Sara Lee's willingness to buy, are set out in Chapters 5 and 4 respectively.

2.36. Negotiations began in January 1991 and continued for some months. Sale and purchase agreements and related documents were signed on 4 October 1991, on which date Sara Lee and Kiwi Brands Inc (a United States subsidiary of Sara Lee) acquired:

- (a) the trade marks and goodwill of, respectively, Reckitt & Colman's United Kingdom and United States shoe care businesses, comprising:
  - (i) the Meltonian, Properts, Cherry Blossom, Magix, Wren's and related trade marks in the United Kingdom;
  - (ii) the Griffin, Meltonian, Properts, Magix, Nulife and related trade marks in the United States;
  - (iii) certain overseas registrations of these trade marks; and

- (iv) Reckitt & Colman's United Kingdom and United States export business;
- (b) some but not all of Reckitt & Colman's packing lines in the United Kingdom and certain other machinery and equipment in the United Kingdom and the United States;
- (c) display stands, mainly as located in retail outlets;
- (d) rights to Reckitt & Colman's shoe care trading in the special trades sector in Australia, Kenya and Zimbabwe; and
- (e) Reckitt & Colman's merchantable stock of relevant branded products.

2.37. The acquisition did not, however, include all Reckitt & Colman's shoe care brands. Amongst the well-known brands it retained was Nugget. Reckitt & Colman retained the book debts (but SL/HPC UK was to give assistance in collecting these) and Reckitt & Colman was to be responsible for paying creditors.

2.38. The total consideration for the world-wide shoe care businesses sold was £[ \* ] million. Some £[ \* ] million, representing mainly trade marks and goodwill as shown in Table 2.18, was apportioned to the United Kingdom transaction.

**TABLE 2.18 Sara Lee: consideration for Reckitt & Colman's shoe care business apportioned to the United Kingdom transaction**

	<i>£ million</i>
Goodwill	[
United Kingdom marks	*
Equipment and display stands	]

*Source:* MMC using Sara Lee data.

In addition, payment was made for certain stocks that were acquired but the amounts involved were not material in the context of the transaction as a whole.

2.39. On completion of the transaction, Reckitt & Colman announced that it intended to close the shoe care manufacturing unit at Hull, though it undertook to supply Sara Lee for a transitional period of six months, by which time production would be (and had by the end of March 1992 been) fully transferred to Sara Lee's plant at Honley. The equipment moved from Hull to Honley comprised a liquid (angle neck) filling line, a jar line for creams, a dye line and mixing tanks and other processing equipment for liquid and cream polishes.

2.40. Reckitt & Colman undertook not to engage in the manufacture, marketing or distribution of shoe care products in the United States and United Kingdom for three years, that is until October 1994. Subject to certain minor restrictions, Reckitt & Colman remained free in the rest of the world to continue the manufacture and sale of shoe care products (other than to the special trades in Australia, Kenya and Zimbabwe-see paragraph 2.36(d)).

### **The effect of the merger on Sara Lee's profits**

2.41. As noted in paragraph 2.22, Sara Lee was unable to comply with our request for a statement of the profits of its United Kingdom applied shoe care products business beyond the end of 1991. We have therefore endeavoured to estimate, from the data available to us, the additional profits that Sara Lee may be deriving from the acquisition of the Reckitt & Colman shoe care business and brands.

\*Figures omitted. See note on page iv.

2.42. We note that according to Table 3.10 sales of Reckitt & Colman's branded shoe polish products in 1991 amounted to some £3.75 million. If Sara Lee were able to earn 10.9 per cent operating profit on sales at this level (10.9 per cent being its rate of operating profit for the year to 30 June 1991 shown in Table 2.11) the merger might increase its profit by around £400,000. In fact, the increase may possibly be somewhat greater because of the way in which Sara Lee could spread any fixed element in its costs over a higher volume of production. Of these 1991 sales, £1.36 million were of products under the Cherry Blossom brand (see Table 3.11) and the additional profit accruing to Sara Lee on these, assuming the same overall profit margin of 10.9 per cent, might be around £150,000 or more, depending again on the effect of spreading any fixed element in Sara Lee's costs over a higher volume of production.

2.43. We have adopted a different approach in seeking to identify the effect on Sara Lee's profits of the main Cherry Blossom product, namely tinned paste polish. Table 3.16 shows a 1991 profit to Sara Lee on all tinned paste polishes of 5.9p a tin on an average manufacturer's selling price of 22p. Of the total costs of 16p, some 8p represents prime costs and 8p represents 'other costs' (mainly production overheads and distribution, sales, marketing and advertising expenditure). As some of those 'other costs' are likely to represent fixed expenditure, the additional profit earned by Sara Lee at its Honley factory on the current annual production of some 4.1 million tins of Cherry Blossom paste polish alone could, on the basis of this calculation and other things being equal, be somewhat higher than on the sales of all Cherry Blossom products as indicated in paragraph 2.42-possibly in the range £240,000 to £570,000, depending on the extent to which 'other costs' are of a fixed nature. As, however, Sara Lee has said that the fixed element on its production costs is relatively modest (see paragraph 3.78), we would expect the additional profit on Cherry Blossom paste polish to be at the lower end of this range.

2.44. The difference between the results produced by these two approaches serves to emphasise the need to treat these exercises in profit estimation with extreme caution.