

## The companies and the merger transaction

### Introduction

1. The merger involved two packers and suppliers of eggs and egg products, both family controlled, which had for more than ten years been among the largest egg-related enterprises in the UK. While, like most of their larger competitors, they had grown organically, the Deans and Clifford Kent/Stonegate enterprises had also made large acquisitions, leading to increased concentration in the egg industry. By the time of the merger, they had become the leading egg packers, each with operations in several regions of the UK, and were the largest suppliers of shell eggs to the four leading grocery retailers.
2. Table 1 shows the turnover and net fixed assets in 1995, 2000, and 2005 of Stonegate Farmers Ltd, Deans and two other companies that have been among their leading competitors over the last ten years.

TABLE 1 Major egg enterprises: ten-year growth

	1995	2000	2005	% growth		
				1995–2000	2000–2005	1995–2005
<i>£'000</i>						
<i>Turnover</i>						
Stonegate Farmers Ltd	79,855	67,300	103,443	-16	54	30
Deans	57,510	171,905	313,791	199	83	446
Fridays	19,967	23,789	26,197	19	10	31
Glenrath	4,597	9,929	24,312	116	145	429
<i>Net fixed assets*</i>						
Stonegate Farmers Ltd	13,909	11,397	16,833	-18	48	21
Deans	11,351	39,156	34,915	245	-11	208
Fridays Ltd	9,024	9,285	7,868	3	-15	-13
Glenrath	1,193	4,977	16,061	317	223	1,246
<i>Turnover: fixed assets</i>						
Stonegate Farmers Ltd	5.7	5.9	6.1			
Deans	5.1	4.4	9.0			
Fridays	2.2	2.6	3.3			
Glenrath	3.9	2.0	1.5			

Source: ICC Plum from statutory accounts.

\*Net fixed assets are net tangible assets less any revaluation reserve.

Note: Deans' figures for 1995 are for Deans Farm Ltd.

3. The table shows that Deans and Stonegate have been much larger in terms of turnover than the other two companies, Fridays and Glenrath, throughout the last ten years. It also indicates that Stonegate had falling turnover over the first five years, followed by a recovery, and that over the ten years since 1995 it has not grown as fast as Deans. The table does not include figures for Oaklands, another large supplier of shell eggs, because many of its sales are made through another business.
4. The table shows the ratio of turnover to net fixed assets. This ratio is much higher for Deans and Stonegate, reflecting the fact that egg packing can be much less asset-intensive than egg production. Glenrath, which has recently invested heavily in egg production facilities, is much more asset-intensive, but has grown over the ten years

even faster than Deans to become a leading supplier of eggs in Scotland and the North.

5. The figures in Table 1 should be treated with some caution. First, they are based on statutory accounts, and may include non-egg activities. Second, the companies may not contain the entire enterprise carried on by their shareholders (for example, Stonegate is now a wholly-owned subsidiary of Clifford Kent (which has another egg production interest, Clarence Court). Third, there is a complex supply chain for eggs; Deans and Stonegate are directly involved at many levels, selling intermediate outputs such as spent hens, feed, and pullets to other companies. Finally, there are third-party suppliers in the various stages of the supply chain, which may have been contracted to one or other of the companies in Table 1 for many years, but whose assets do not appear on their balance sheets.
6. Deans and Stonegate differ from the other suppliers of eggs in the UK in the extent of the acquisitions that they have made. Their principal acquisitions are set out in Table 2.

TABLE 2 Deans and Stonegate: principal acquisitions

<i>Year</i>	<i>Acquiror</i>	<i>Target</i>
1987	Deans	Goldenlay Foods Ltd
1997	Deans	H D Hardie & Co Ltd
1997	Deans	Dell Foods (Chilled Products) Ltd
2000	Deans	Daylay Foods Ltd
2001	Stonegate	Thames Valley Foods Ltd
2002	Deans	Countryside Free Range Eggs Ltd*
2003	Deans	Freshlay business†
2004	Clifford Kent Ltd	Clarence Court business
2005	Stonegate	Lincolnshire Chickens Ltd

Sources: Deans and Stonegate.

\*From Stonegate.

†From W J Watkins.

## Clifford Kent and Stonegate

### ***Group background***

7. In its submission, Stonegate told us that it was first established as a cooperative by local farmers in and around the village of Stonegate, near Tunbridge Wells in Kent, in 1926. The company grew through the post-war years, extending both its supply base and its sales. Stonegate changed its status from a cooperative to a limited company in 1962. Following the disbanding of the British Egg Marketing Board in 1971, Stonegate experienced a successful period, during which it moved into egg production to maintain and secure its cage egg supply base, building chicken houses on existing sites and also acquiring new farms.
8. The Stonegate website gives a brief history of the Clifford Kent enterprise. In 1949, Clifford and Margaret Kent were given 50 hens as a wedding present. Following Clifford Kent's retirement in 1985, his son Michael Kent purchased his Horizon Farms business. In 2000, Michael Kent acquired about 44 per cent of the ordinary shares of Stonegate (held through his company, Clifford Kent). He stated that within a year he had reversed the fortunes of a company that was losing money.

9. In October 2001, to improve and widen its customer base, Stonegate completed the acquisition of Thames Valley Foods Limited, another egg supplier. This acquisition made Stonegate the second-largest shell egg supplier in the UK.

### **Facilities and businesses**

10. Stonegate told us that it is now a vertically-integrated shell and processed egg supplier, which owns [X] farms across the country producing about [X] per cent of UK shell eggs, [X] packing facilities accounting for [X] per cent of shell eggs packed in the UK, and supplies [X] per cent of all shell eggs and [X] per cent of all processed eggs sold in the UK. The range of shell eggs supplied by Stonegate includes cage eggs, barn eggs and free range eggs (comprising organic eggs and other free range eggs). Stonegate is also involved on a small scale in the supply of pullets (young chickens on the point of starting to lay eggs) to third-party egg producers.
11. At the time of the merger, Stonegate was supplying major retailers, processors and commercial customers from the following packing facilities:
  - (a) Its own packing facility in Lacock, Wiltshire. This was originally a small packing centre with six large cage poultry houses on site which packed Stonegate's own production. It has since been expanded and the poultry removed from the houses to create warehouse space. Lacock was packing organic, free range and barn eggs, and acting as a distribution depot and trans-shipment centre for cage eggs packed at the on-farm packing centres. Recently, Lacock has been expanded to add a second packing centre at the site.
  - (b) Two contract packers, STC Packers Ltd and Walston Poultry Farm Ltd. STC was packing mostly cage eggs, and acting as a distribution point for the north of England. Walston Poultry is based in Dorset and packs a small volume of eggs for Stonegate.
  - (c) Five on-farm packing centres (in Liskeard, Swansea, Lyndons, Seisdon, and Steeple Ashton), which were responsible for the packing of value cage eggs.
12. A submission to the OFT from the economic advisers to the parties included two annexes which showed their business models. Stonegate is less vertically-integrated than Deans. Its Agricultural division operates rearing farms and laying farms, the Shell Egg division has three packing centres and six main repacker farms, and the Egg Product division has factories in Somerset and south Wales. There are no breeding farms or hatcheries, so it buys in day-old chicks from third parties. Although the submission did not show a feed mill activity, the parties' presentation to the banks stated that there were feed mills in Cornwall and Lincolnshire (these are exclusively for internal supply and make no outside sales).
13. Almost any of the stages of production, including those where Stonegate has its own facilities, can be subcontracted to provide additional capacity.

### **Group organization**

14. In January 2005 Clifford Kent still owned only 44 per cent of the share capital of Stonegate, but before the merger it bought out nearly all the minority shareholders (see paragraph 53) and became the holding company for the Clifford Kent/Stonegate side of the merger.

15. Clifford Kent has a non-Stonegate subsidiary, Clifford Kent Ltd, through which in 2004 it acquired [X] of Clarence Court, a producer of speciality eggs, [X].

### Financial performance

16. The financial performance of Stonegate (including Clifford Kent and its subsidiaries) for the three years before the merger is summarized in Table 3.

TABLE 3 Stonegate: summary of financial performance

£ million

Years ended 30 September

	2003	2004	2005
Turnover			
Operating profit			
Cash inflow from operations			
<i>Ratio to turnover %</i>			
Operating profit			
Cash inflow from operations			

Source: Parties' presentation to banks, Table 34.

17. [X]

18. Table 4 shows the turnover and operating profit of Stonegate (without Clifford Kent) for the last ten years, based on its statutory accounts. It also shows our calculation of average net operating assets. We have excluded goodwill and the effects of asset revaluations from assets so that they are shown at approximately their historical cost.

TABLE 4 Stonegate: summary of financial performance

£'000

Year to September	Turnover	Operating profit	Average operating assets	Return on sales %	Asset turnover (times)	Return on assets %
1996	92,157	3,659	18,653	3.97	4.94	19.6
1997	90,885	2,692	19,149	2.96	4.75	14.1
1998	85,751	-2,386	17,577	-2.78	4.88	-13.6
1999	74,871	-191	15,320	-0.26	4.89	-1.3
2000	67,300	1,204	12,887	1.79	5.22	9.3
2001	64,903	1,006	15,961	1.55	4.07	6.3
2002	104,646	-434	19,128	-0.41	5.47	-2.2
2003	90,751	1,876	18,622	2.07	4.87	10.1
2004	108,568	1,796	20,590	1.65	5.27	8.7
2005	103,443	2,376	24,387	2.30	4.24	9.8
Average	88,328	1,160	18,227	1.31	4.85	6.4

Source: ICC Plum from Stonegate group accounts.

19. The table shows that Stonegate's turnover has fallen in all the years in which it did not make an acquisition. Its operating margin was below 2 per cent from 1998 to 2003, since when it has been more stable. It has not returned to the higher levels achieved in 1996 and 1997. This is also the case with Deans, suggesting that there was a significant change in the industry after 1997. Commenting on this, the parties told us that there had been a drop in the wholesale price of shell eggs in 1998 due to an excess of supply. [X] It said that it was also possible that 'hard discounters', such as Aldi, had entered the market in this period. Established multiple retailers had

responded by launching 'value eggs', precipitating a price war at the retailer level [X].

20. In the most recent year, sales declined as Stonegate [X], but it succeeded in increasing profits and cash flow.

### Historical indebtedness

21. Using Stonegate's statutory accounts (excluding Clifford Kent), we have looked at its historical levels of indebtedness, using two measures:

- the ratio of net debt to capital employed (which may be distorted if year-end balance sheets are not typical of the year as a whole); and
- the ratio of profit before interest and tax (PBIT) to interest expense (also known as times interest earned or interest cover).

These are shown in Table 5.

TABLE 5 Stonegate: measures of indebtedness

Year to September	Capital employed	Net debt	Debt %	PBIT	£'000	
					Interest	Interest cover (times)
1996	19,044	8,942	47.0	4,046	555	7.3
1997	19,253	8,056	41.8	2,959	584	5.1
1998	15,900	7,283	45.8	-2,560	838	-
1999	14,739	7,017	47.6	-174	721	-
2000	11,034	2,586	23.4	1,313	609	2.2
2001	20,888	14,091	67.5	1,081	501	2.2
2002	17,368	11,774	67.8	-1,035	1,043	-
2003	19,875	13,249	66.7	1,703	930	1.8
2004	21,304	12,888	60.5	2,155	926	2.3
2005	27,469	17,682	64.4	<u>2,091</u>	<u>939</u>	2.2
Average				11,579	7,646	1.5

Source: ICC Plum from Stonegate group accounts.

22. The table shows how capital employed increased in 2001 with the acquisition of Thames Valley, partly offset by the sale of Countryside Free Range Eggs Ltd (Countryside Free Range Eggs) to Deans in the following year. In 2005, Stonegate acquired Lincolnshire Chickens, one of Deans' producers. In the last five years, the ratio of debt to capital employed has exceeded 60 per cent, and interest cover has been around two times. Over the ten-year period in the table, Stonegate has paid out 66 per cent of its pre-tax profits in interest. In short, Stonegate has been fully borrowed.

23. Table 5 is for Stonegate only, and takes no account of Clifford Kent and its other subsidiaries. At the end of 2005, Clifford Kent owned only 44 per cent of Stonegate, and borrowed about £[X] million to acquire the rest of the shares. Clifford Kent had recently acquired the Clarence Court business (see paragraphs 14 and 15).

## Deans

### **Group background**

24. The Deans egg marketing business was originally founded as Deans Brothers in the 1930s, providing an outlet to market for egg producers in the Hertfordshire/Buckinghamshire area. By the time that it was acquired by the Dalgety group in 1969, Deans Farm Eggs had built a significant presence in the egg sector, supplying the growing high street multiple retailers. Under Dalgety's ownership, the former Sainsbury-Spiller egg packing and production operation was consolidated, and in 1987, the customer and supply base was broadened through the addition of Goldenlay Foods. The salmonella scare of the late 1980s undermined Dalgety's enthusiasm for Deans. Dalgety identified Deans as being non-core and of insufficient critical mass, and consequently returned the business to private, family ownership in 1991 under managing director and majority shareholder Peter Dean.
25. Deans succeeded in achieving organic growth, but the shell egg sector remained cyclical. A counter-cyclical balance was provided by moving into egg processing in 1997. Small businesses were acquired in Scotland (HD Hardie & Co Ltd), and the East Midlands (Dell Foods (Chilled Products) Ltd), and food manufacturers were added to the customer base.
26. In 2000, Deans diversified into feed milling, poultry processing while strengthening its position in egg production, packing and processing, through the acquisition of Daylay Foods Ltd (Daylay). This transformed Deans from a company generating £[x] million revenues a year to one with over £[x] million revenues a year. Since that period, Deans' annual turnover has increased to over £[x] million with the purchase of Countryside Free Range Eggs from Stonegate in 2002 and as a result of acquiring the Freshlay business in October 2003 and entering into an agreement to operate its Devon packing centre, and taking over the sale and marketing of its eggs.

### **Facilities and businesses**

27. Deans is now a company with national coverage in Great Britain and currently operates at almost all levels of the shell and processed egg supply chain. Deans produces its own feed; owns or contracts with a number of farms with activities including the production of fertile eggs, pullets or shell eggs, hatcheries producing day-old chicks; egg packing centres; egg product factories for producing egg products and a hen processing factory for producing poultry meat.
28. Before the merger, Deans was the largest supplier of shell eggs in the UK, supplying approximately [x] million cases in the year to September 2006. Currently Deans packs and supplies shell eggs from the following packing centres:
  - (a) three centres in Scarle (Lincolnshire), Thornton (Fife), and Holsworthy (Devon). Together these packing centres accounted for 54 per cent of the cases packed by Deans in 2005;
  - (b) two centres in Walesby (Nottinghamshire) and Standlake (Oxfordshire). These centres were converted to on-farm grading in November 2006;
  - (c) Gubblecote (Hertfordshire). This centre ceased operating as a packing centre at the end of October 2006; and
  - (d) in addition one producer, N Moore, contract-packs on a farm at Betley (Cheshire).

Deans also supplies liquid eggs and boiled eggs to manufacturing companies, wholesale and catering companies.

29. The submission to the OFT by the parties' economic advisers included an annex showing the business model of Deans. As indicated above, it is more vertically-integrated than Stonegate. Like Stonegate, its capacity at various levels of the supply chain is augmented by contractual relationships with a variety of outside suppliers.

### Financial performance

30. The financial performance of Deans for the three years before the merger is summarized in Table 6.

TABLE 6 Deans: summary of financial performance

*£ million*

Years ended 30 September  
2003    2004    2005

Turnover	(	)	✂
Operating profit			
Cash inflow from operations			
Ratio to turnover %			
Operating profit			
Cash inflow from operations			

Source: Parties' presentation to banks, Table 33.

31. Table 6 shows [✂].
32. Table 7 shows the turnover and operating profit of Deans Food Group Ltd for the last ten years, based on statutory accounts. It also shows our calculation of average net operating assets. As with Stonegate (see Table 4), we have excluded goodwill and the effects of asset revaluations.

TABLE 7 Deans: summary of financial performance

Years to September	Turnover	Operating profit	Average operating assets	Return on sales %	Asset turnover (times)	Return on assets %
1996	64,183	3,305	10,262	5.15	6.25	32.2
1997	79,658	4,820	14,247	6.05	5.59	33.8
1998	83,821	1,855	18,936	2.21	4.43	9.8
1999	85,855	2,164	19,981	2.52	4.30	10.8
2000	171,905	2,602	37,813	1.51	4.55	6.9
2001	215,100	4,058	52,741	1.89	4.08	7.7
2002	229,703	6,110	50,176	2.66	4.58	12.2
2003	255,050	7,262	49,262	2.85	5.18	14.8
2004	336,821	8,571	48,989	2.54	6.88	17.5
2005	313,791	7,238	50,485	2.31	6.22	14.4
Average	183,589	4,799	35,289	2.61	5.20	13.6

Source: ICC Plum from Deans Food Group Ltd group accounts.

33. In some years Deans has grown rapidly because of acquisitions (particularly Daylay in 2000, Countryside Foods in 2002, and Freshlay in 2003). Since 1997, its operating margin has been consistently less than 3 per cent, but its operating margin and asset turnover have been higher than those of Stonegate (see Table 4) so that it had an

average annual return on average net operating assets of 13.6 per cent, compared with 6.4 per cent for Stonegate.

34. Deans' management accounts give a more detailed picture of its performance. Table 8 shows the profit and loss for each of its businesses for the year to September 2005. The management accounts for the previous year were presented in a less detailed format and are summarized at the foot of the table.

TABLE 8 Deans: profit and loss by activity, year to September 2005

	Shell egg	Products	Feed	Poultry	Central	Total
£'000						
<b>Turnover</b>						
Internal						
External						
<b>Cost of materials</b>						
<b>Margin after materials</b>						
Processing costs						
Distribution						
Overheads						
Management recharges						
<b>Trading profit/loss</b>						
Exceptional items						
Asset disposals						
<b>EBIT</b>						
<i>Ratio to total turnover (%)</i>						
Internal turnover						
Margin after materials						
Trading profit						
<i>Share of external turnover (%)</i>						
<i>Share of trading profit (%)</i>						
<i>Summary of 2004</i>						
External turnover						
Trading profit						
<i>Ratio to total turnover (%)</i>						
Trading profit						
<i>Share of external turnover (%)</i>						100.0
<i>Share of trading profit (%)</i>						100.0

Source: Deans.

35. The table shows that in both years, shell eggs accounted for more than [X] per cent of Deans' turnover, [X]. Comparing the trading margins for the two years, total trading margins in 2004 and 2005 were [X] per cent, but the shell egg margin [X] from [X] to [X] per cent, while that from egg processing [X] from [X] to [X] per cent over the two years. This demonstrates the counter-cyclical advantage of being involved in both shell egg and egg processing activities.
36. Deans also calculates return on capital employed for each of its businesses. This is a better measure of profitability than trading or operating margin.

TABLE 9 Deans: return on capital employed by division

	<i>per cent</i>		
	2003	2004	2005
Shell eggs	(	✂	)
Egg products			
Milling			
Poultry			
Total company			

Source: Deans.

### Historical indebtedness

37. As with Stonegate, we calculated the ratio of debt to capital employed and the interest cover in terms of the ratio of PBIT to net interest expense for each of the ten years to September 2005.

TABLE 10 Deans: measures of indebtedness

Year to September	Capital employed	Net debt	Debt %	PBIT	<i>£'000</i>	
					Interest	Interest cover (times)
1996	10,262	1,889	18.4	3,381	354	9.6
1997	18,232	9,581	52.6	4,930	733	6.7
1998	19,639	10,126	51.6	2,028	1,017	2.0
1999	20,322	9,552	47.0	2,214	943	2.3
2000	55,303	30,667	55.5	3,030	2,231	1.4
2001	50,179	23,839	47.5	4,699	2,394	2.0
2002	50,172	21,913	43.7	6,369	1,674	3.8
2003	48,351	15,272	31.6	7,505	1,334	5.6
2004	49,627	11,598	23.4	8,244	1,404	5.9
2005	51,342	2,328	4.5	12,306	1,189	10.3
Average				54,706	13,273	4.1

Source: ICC Plum from Deans' group accounts.

38. Table 10 shows that Deans increased its net debt from about £10 million in 1999 to over £30 million in 2000, when it acquired Daylay (increasing capital employed by £35 million). In the subsequent five years, it paid down almost all of this debt in spite of further acquisitions (Countryside Free Range Eggs in 2002 and Freshlay in 2003).

39. Deans' indebtedness immediately before the merger was £[✂].

### The merger transaction

40. [✂]

41. Noble told us that discussions with Michael Kent and his advisers did not commence until autumn 2004. The merger was completed in June 2006 after protracted negotiations.

42. [✂]

## Parties' presentation to banks

43. The parties, assisted by their advisers, prepared a detailed presentation for banks that might provide finance for the merger. In December 2005, it was circulated and set out the principal features and rationale of the merger. It stated that shell eggs represented the core of the company's business, particularly supply to the retail sector and the multiples which dominate it. Shell egg sales would account for about [X] per cent of total sales, and reducing the unit costs of production of these sales was a key objective of the proposed merger. [X] The application of this model to [X] Deans, together with the exploitation of other synergies between the two businesses, would reduce operating costs across the group to enable higher profit margins.
44. The enlarged group would pack eggs from both independent producers and its own farms for onward sale to food retailers, food service distributors, and egg wholesalers. Table 11 shows the estimated combined share of egg business by retailer.

TABLE 11 Parties presentation to banks: estimated shares of retailers' egg purchases, December 2005

Customer	Estimated volume cpw	Share of customer's egg purchases %			
		Deans	Stonegate	Noble	Other suppliers
<i>Deans only</i>	)				
Tesco					
Marks & Spencer					
Co-op					
Netto					
Nisa					
McDonald's					
<i>Stonegate only</i>					
Waitrose				X	
<i>Shared</i>					
Sainsburys					
Asda					
Morrisons					
Somerfield					
Iceland					
Aldi					

Source: Parties' presentation to banks, Table 5.

[X]

45. Key customers for egg products include [X]. The new business would also have facilities for processing spent hens into meat, as well as milling poultry and pig feed for both its own farms and third parties. The combined business was forecast to make earnings before interest, taxation, depreciation and amortization (EBITDA) of some £[X] million [X] on sales of £[X] million in the year to 30 September 2006. The financial projections were originally based on an assumption that the companies would merge in October 2005, but the merger was delayed until June 2006. The new business was estimated to have the shares of supply shown in Table 12.

TABLE 12 **Parties' presentation to banks: estimated shares of UK supply, December 2005**

<i>Product</i>	<i>Share of supply</i>
Shell eggs	[REDACTED]% of egg supply [REDACTED]% of retail egg volume
Egg products	[REDACTED]% of sales value
Animal feed	[REDACTED]% of volume
Poultry meat	[REDACTED]% of volume

Source: Parties' presentation to banks, Table 5.

46. The parties' presentation to banks stated that the principal objectives of the merger were to:

- (a) create a vertically-integrated, market-leading business in the UK egg industry [REDACTED];
- (b) [REDACTED];
- (c) [REDACTED];
- (d) [REDACTED];
- (e) [REDACTED]; and
- (f) [REDACTED].

### **Synergies**

47. It also identified several synergy benefits arising from the merger: [REDACTED]. These items would deliver savings of more than £[REDACTED] million (included within initial EBITDA of £[REDACTED] million—see paragraph 45) in the first year, increasing to more than £[REDACTED] million when fully implemented. Further opportunities for savings had been identified in [REDACTED], but their timing and amount had not been calculated.

### **Actions before the merger**

#### *Property valuations*

48. [REDACTED]

#### *Due diligence*

49. Financial due diligence on both the merging parties was carried out by reporting accountants. They looked at the recent performance of Deans and Stonegate, and at the revised financial projections for the merged entity. [REDACTED]

50. [REDACTED]

51. [REDACTED]

52. [REDACTED]

## Stonegate minorities

53. On 29 July 2005, Clifford Kent, which then held 44.13 per cent of the ordinary shares of Stonegate,<sup>1</sup> made an offer of [£] per share to all the other shareholders. As a result of this offer, it acquired 433,000 shares giving it a majority holding. [£]

## Supply agreements with Lloyds (Animal) Feeds Limited (Lloyds Animal Feeds)

54. Stonegate told us about its long-standing supply agreements with Lloyds Animal Feeds [£]. Lloyds Animal Feeds was a leading supplier of animal feed [£] and had other businesses, including the production of eggs. It also held 15 per cent of the ordinary shares of Stonegate.
55. We have to look at changes that were brought about by the merger. [£]
56. [£]

## Merger terms and financing

57. The transaction was completed on 23 June 2006 when Goodmix, a company formed by Peter Dean and Michael Kent, acquired all the issued share capital of Clifford Kent (the parent company of Stonegate) and Deans. Goodmix subsequently changed its name to Noble Foods Limited.
58. Table 13 shows the financial performance of the merging entities as reported in the parties' presentation to banks. The figures were based on the 2004/05 accounts.

TABLE 13 Noble: projected contributions of the merging parties

	£ million			per cent	
	Stonegate	Deans	Combined	Stonegate	Deans
Turnover					
Operating profit					
Cash inflow from operations					
Land and buildings					
Plant and machinery					
Working capital					
Provisions					
Operating assets					
Net debt					
Net assets					
<i>Ratios (%)</i>					
Operating profit: turnover					
Turnover: operating assets ( <i>times</i> )					
Operating profit: operating assets					
Cash inflow: operating assets					

Source: Parties' presentation to banks, Tables 3, 33, and 34.

59. The table shows that [£]. Deans was much the bigger enterprise, [£].
60. [£] by the Deans' shareholders taking:

<sup>1</sup>1,183,505 out of 2,681,527 ordinary shares of £1 each.

(a) £13 million in preference shares;

(b) £[~~3~~] in cash, [~~3~~]; and

(c) 100 ordinary shares.

Noble paid for the entire issued share capital in Clifford Kent by the issue and allotment of 100 ordinary shares. This effectively transferred Clifford Kent's ownership of Stonegate shares.

61. [~~3~~] The preference shares are redeemable in four annual tranches between June 2009 and June 2012, so they are effectively a form of deferred consideration.
62. [~~3~~]
63. At completion the net asset value of Clifford Kent and its subsidiaries was £[~~3~~] and of Deans and its subsidiaries was £[~~3~~]. The derivation of these amounts and of the opening net assets of the newly merged group is shown in Table 14.

TABLE 14 Noble: opening post-merger balance sheet

£'000

	CKHL	Deans	As	Combined	Adjustments	Noble
		Pre-merger	Adjustments*	restated		
Fixed assets						
Intangible assets and goodwill						
Investments						
Stock						
Debtors						
Creditors & provisions						
Cash at bank						
HP & leasing creditors						
Bank overdraft/						
Invoice finance and headroom						
Term loan - lead lender						
Term loan - Lloyds Animal						
Feeds TSB						
Vendor loan						
Net debt						
Net assets						
Ordinary shares						
Preference shares						
Reserves						
Equity						
Equity + net debt						
Gearing based on:						per cent
Total net debt						
Net debt excluding leases						
Net debt excluding vendor loan						
Including preference shares in debt						

Source: Noble.

\*Deans' accounts adjusted to reflect withdrawal of assets by Peter Dean.

64. Table 14 shows that only £[~~£~~] of negative goodwill arose on the merger. A value of £[~~£~~] million was attributed to the 200 ordinary shares, reflecting the net assets acquired, including the revalued properties. It was noted that debt would increase by £[~~£~~] million for Stonegate minorities and about £[~~£~~] million for merger costs.
65. The merger transaction required the raising of additional loan finance, [~~£~~]. Table 14 shows that the newly merged group had gearing of 59.4 per cent, compared with 55.6 per cent for Stonegate and 29.2 per cent for Deans. Although these appear to be well within the gearing of the two merging companies over the last ten years (see Tables 5 and 10 respectively), the pre-merger asset revaluations have had the effect of reducing the gearing ratios in Table 14 so that they are not comparable with earlier years. Deans' assets were increased by £18.9 million as the result of revaluations in the two years to September 2006, while those of Clifford Kent were increased by £[~~£~~]. But, whatever these ratios, the first priority for the borrowers is to generate enough cash from operations after necessary capital expenditure to service their loans. Table 5 shows that, in the past, Stonegate operated with a high level of debt, while Table 10 shows that Deans was able to generate enough cash to pay off loans of about £28 million in the five years to September 2005.

66. Noble's principal bankers made the following secured facilities available:
- (a) revolving facility £[X] million;
  - (b) group term facility £[X] million; and
  - (c) headroom facility £[X] million.
67. The revolving facility is secured on the debtor book [X].
68. The term facility is secured on the group's properties and is repayable over [X] years. [X]
69. The headroom facility was made available, we were told, [X].
70. [X]
71. Noble told us that if we proceeded with any proposal, following our provisional findings, for the divestiture of Stonegate or Deans, it would face difficulties with its bankers. Some of the synergies would not be realized. The high level of property assets in Stonegate (see paragraph 68) meant that its share of group borrowings was more than £[X] million, which was more than Stonegate could service on its own.