Bass Pro Shops/Cabela's: Heightened Promotional Competition in Overlap Markets, Lack of Divestiture Obligation Drive FTC Clearance Risk

Deal Update

On October 3, 2016, Bass Pro Shops announced an agreement to acquire rival outdoor sports retailer Cabela's Incorporated in a transaction valued at approximately $5.5 billion.

The two companies compete closely on format, assortment, and core customer, and given the stores' broad draw areas, a *Capitol Forum* analysis shows substantial geographic overlap. More importantly, analysts report that the two companies, already aggressively promotional, actually heighten sales and markdown activity in geographic markets in which their stores compete head to head. Such evidence is key to the FTC's effects-focused approach to retail merger analysis, and this existing promotional interaction creates FTC clearance risk.

Exacerbating this risk is the parties' merger agreement, which provides that Bass Pro Shops has no obligation to agree to any level of divestitures in order to obtain antitrust clearance. This unusually aggressive language, which at first glance precludes the possibility of settlement, indicates that the FTC's investigation will very likely result in a binary outcome—either unconditional clearance, or a full-stop injunction.

In-depth: Product Market, Geographic Market, and Competitive Effects

Deal overview—close direct competition in fragmented national market. Both Cabela's and Bass Pro Shops sell a wide variety of hunting, camping, fishing, and general outdoor merchandise in large-footprint stores across the United States. "Bass Pro Shops and Cabela's have very similar customer bases and business models," explains Nathan Yates, Director of Research at Forward View Consulting. "90% of the merchandise is the same, excluding store brands. Most Cabela's customers have shopped at Bass Pro Shops and vice-versa."

Although close, direct competitors, the companies ostensibly compete in a highly fragmented national marketplace. According to the company's Q3 2015 investor presentation, Cabela's has just a 4.3% share of the outdoor addressable market, with specialty competitors Bass Pro (3.5%), Gander Mountain (2.0%), Sportsman's Warehouse (1.2%) and Scheels (0.7%) accounting for very low single digit shares. The remaining market is divided amongst Walmart (15.6%), full-line sporting goods retailers (most prominently, Dick's Sporting Goods) (8.6%), and other outdoor entities (64.1%).

That said, given the companies' outdoor focus, service level, and unique features (stores oftentimes include restaurants, aquariums, taxidermy displays, and archery and shooting ranges) Bass Pro and Cabela's are somewhat differentiated from their full-line sporting goods and mass merchandiser competitors. Although full-line sporting goods retailers stock some hunting, fishing, and outdoor gear, notes Yates, Bass Pro and Cabela's dedicated angler and shooter core customers are unlikely to frequent stores such as Dick's except for convenience/special sales.

Given geographic ubiquity, selection, and low prices, Walmart may provide a somewhat closer competitive check on Cabela's and Bass Pro. At the same time, the companies' outdoor expertise, assortment and service levels (outdoor sports are high-touch, whether selecting hiking boots or rigging a boat) in particular, provide some differentiation. “There’s absolutely no comparison – these people are experts in hunting, fishing, camping, there’s no comparison between them and a Walmart,” says Howard Davidowitz, chairman of Davidowitz & Associates, Inc. a national retail consulting and investment banking firm.

Cabela’s and Bass Pro also compete to some extent with mom-and-pop fishing tackle and gun shops. “Mom & Pop stores can still thrive in small towns with no Cabela’s or Bass Pro,” especially with a focus on niche gear or location, says Yates. That said, given purchasing, marketing, and cost advantages, a Cabela’s or Bass Pro presence—not unlike Walmart in general retail—oftentimes drives smaller competitors out of business. “In communities with a Bass Pro or Cabela’s, Mom & Pop shops typically disappear,” says Yates.

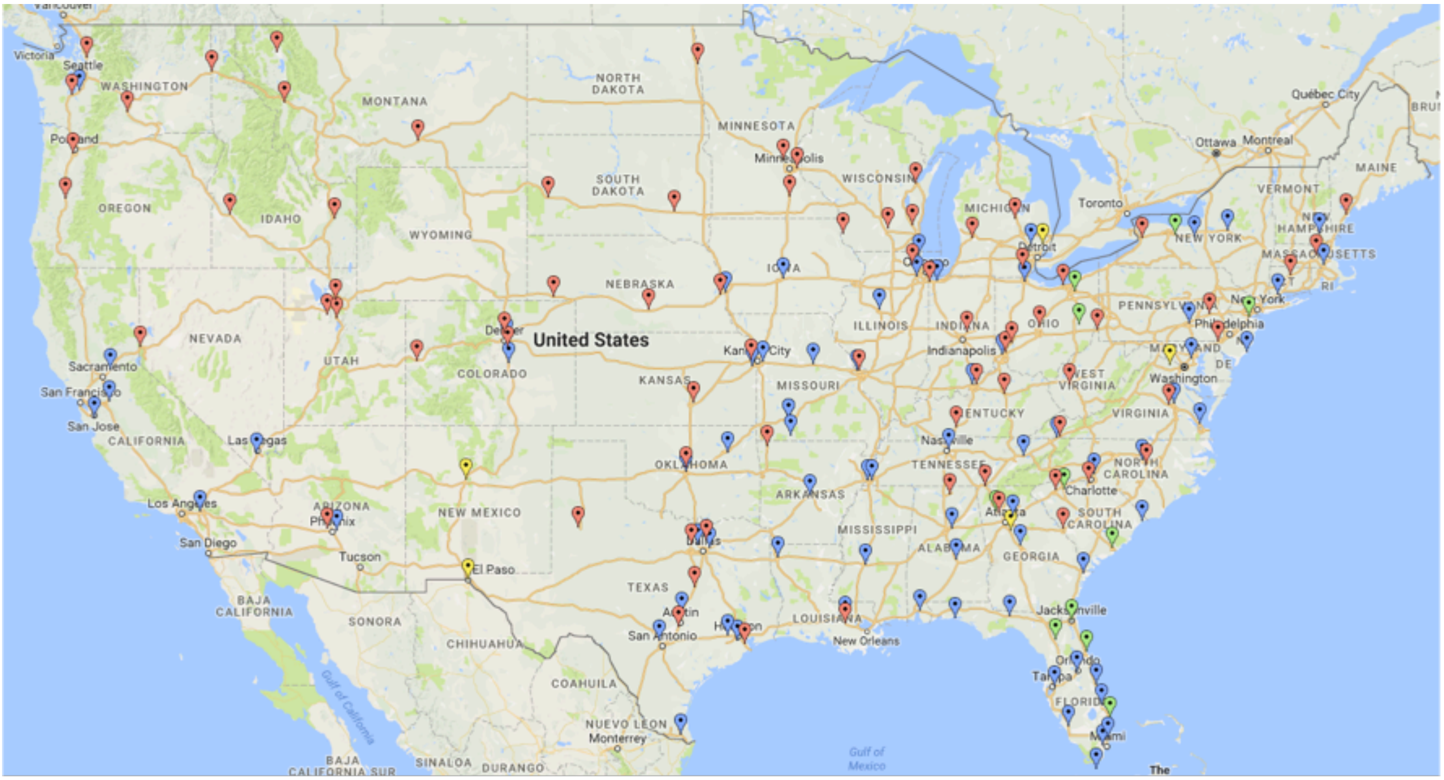
A final competitive threat is online, from Amazon and other e-tailers. Cabela’s and Bass Pro’s expertise and unique store formats, however, may provide at least some insulation from online competition. “Amazon can’t do what they do. They’re in the service and entertainment business, and Amazon can’t do that,” explains Davidowitz. Furthermore, the companies’ firearms businesses—Cabela’s generated 48.4% of its 2015 retail revenue from the hunting category—are largely protected from online competitors, who are prohibited from shipping firearms (or in some cases ammunition) direct to consumer.

Parties pitch complementary geographic footprint, but stores’ broad draw areas suggest overlap. General competitive environment aside, retail markets are inherently local, as consumers are typically willing and able to travel only a limited distance from their home or work to shop. As a result, FTC review will focus on the companies’ local overlaps, and those markets’ unique competitive conditions.

The companies pitch their geographic footprints as highly complementary, with Cabela’s largely centered in the Western US, and most Bass Pros located East of the Mississippi. However, the parties’ stores do overlap substantially—a situation exacerbated by the stores’ broad draw areas, and concomitant broad geographic markets.

Retailers typically draw a substantial majority of their shoppers from a relatively limited geographic radius—a suburban supermarket may have a three-mile draw area, for example, an exurban Walmart Supercenter ten. Given their unique features, locations, and core customers, however, Cabela’s and Bass Pro draw shoppers from a very broad geographic radius—in a press release announcing its most recent store opening, for example, Bass Pro Shops reports that its “average customer…drives an average distance of 50 plus miles” to visit its stores.

When accounting for the stores’ broad draw areas, there is, in fact, significant geographic overlap between the two chains. According to a *Capitol Forum* analysis, of the 84 existing (or planned) US Bass Pro Shops, 8 (9.5%) are within 10 miles of an existing (or planned) Cabela’s, 22 (26.2%) are within 25 miles of an existing (or planned) Cabela’s location, and 35 (41.7%) within 50 miles of an existing (or planned) Cabela’s.



(red-Cabela's, blue-Bass Pro, yellow-planned Cabela's, green-planned Bass Pro)

Competitive conditions vary—specialty outdoor retailers not present in many overlap markets. Again, measured nationally, Cabela's and Bass Pro's shares of the outdoor addressable market are relatively marginal. However, in some overlap geographic markets, including Bristol TN/VA (Bass Pro: Bristol, TN, Cabela's: Bristol, VA (separated by 8 miles)); Anchorage, AK (Bass Pro: Anchorage, AK, Cabela's: Anchorage, AK (9 miles)); Omaha, NE (Bass Pro: Council Bluffs, IA, Cabela's: La Vista, NE (16 miles)); Richmond, VA (Bass Pro: Ashland, VA, Cabela's: Short Pump, VA (19 miles)); and Baton Rouge, LA (Bass Pro: Denham Springs, LA, Cabela's: Gonzales, LA (28 miles)), the combined entity's share will be substantially higher.

This is especially the case given that, in many situations, the specialty retailers Cabela's identifies as competitors in either its most recent 10-K or investor presentation (Gander Mountain, Sportsman's Warehouse, Scheels, Orvis, The Sportsman's Guide), lack a presence in overlap geographic markets. For example, neither Gander Mountain, the company's largest specialty competitor, nor Sportsman's Guide operate a store within 50 miles of any of the five overlaps listed above. Sportsman's Warehouse and Scheels outlets are located within 50 miles of a Cabela's or Bass Pro in only one market each—Anchorage and Omaha, respectively—and Orvis is present in two of five overlap markets—Richmond and Baton Rouge.

Competitive effects, zone pricing, and retail market definition. To be clear, even in overlap markets with no other large specialty outdoor competitors, Cabela's and Bass Pro compete at least to some extent with mass merchandisers, full-line sporting goods stores, mom-and-pop retailers, and direct and online sellers that sell hunting, fishing, and other outdoor equipment. And any market definition limited to, for example, outdoor specialty retailers, would, at least at first glance, appear overly narrow.

FTC retail market definition, however, is an effects-focused exercise—a factor that has led to ostensibly gerrymandered product market definitions including "consumable office supplies sold through office supply superstores" and "premium, natural and organic supermarkets." In fact, in the FTC's seminal retail case, Staples/Office Depot (1997), the Commission supported its "consumable office supplies sold through office supply superstores" market definition with evidence that Staples' pricing varied depending on the presence or absence of a competing office supply superstore—a competitive set limited to Office Depot and OfficeMax.

This evidence led the district court to enjoin the merger, based on the relatively straightforward conclusion that Staples' acquisition of a competitor that uniquely constrained its pre-merger pricing would enable Staples to increase prices post-merger. And today, the *Staples* approach is so well-established that existing zone pricing tends to preclude companies from suggesting deals involving zone-pricing competitors, with Dollar General's 2014 approach to Family Dollar—which the company ultimately abandoned after significant FTC pushback—a notable recent exception.

Analysts report that Cabela's, Bass Pro heighten promotional activity in overlap markets. According to Yates, Cabela's does not appear to zone price, or otherwise vary list prices based on the presence or absence of a Bass Pro's location. However, existing zone pricing, although the most straightforward indicator of a retail merger's potential effects, is not the only such evidence. And notably, such evidence may exist in this situation—as analysts report that both Cabela's and Bass Pro promote more aggressively in markets in which the companies' stores overlap.

For example, shortly after deal announcement, a D.A. Davidson & Co. analyst wrote "Both Cabela's and Bass Pro Shops used promotions to drive store traffic and market share, *especially in contested geographic regions*. As a combined entity, we see potential for a more rational promotional environment to emerge, benefiting all industry participants" [emphasis added]. Yates echoes this viewpoint. "Overlapping markets drive promotional activity even higher," he explains. "In these markets, there have been bigger and/or more frequent sales because Cabela's and Bass Pro were trying to appeal to the same people."

The companies' heightened sales and markdown activity in overlap geographic markets represent a potentially significant hurdle to FTC clearance. Even to the extent market definition is unclear or market concentration numbers underwhelming, existing promotional interaction would appear to provide FTC staff a relatively straightforward story that the merger would lessen promotional competition in overlap markets, and, as a result, lead to higher prices post-merger.

Bass Pro Shops did not respond when contacted for comment about the companies' promotional practices in overlap markets. A Cabela's spokesperson declined comment.

Merger agreement—lack of divestiture obligation drives potential binary outcome. Of course, even if FTC staff were to conclude that the merger would lessen promotional competition in some areas, the issue may prove fixable. With very limited exceptions (Staples/Office Depot (1997), Kroger/Winn-Dixie (2000) Whole Foods/Wild Oats (2007)), the FTC addresses retail overlaps by consent order, through which parties agree to divest overlap stores to an upfront buyer.

The Bass Pro/Cabela's merger agreement, however, renders such an outcome highly unlikely. Although requiring each side to use reasonable best efforts to obtain antitrust clearance, the agreement expressly provides that "neither [Bass Pro] nor any of its affiliates shall be obligated to consent to any divestiture or other structural or conduct relief in order to obtain clearance from any Governmental Entity."

The absence of any divestiture obligation is unusual. In retail mergers the parties position as settlement-track, divestiture commitments are typically capped by materiality (Albertsons/Safeway) or store count (Walgreens/Rite Aid). And even in recent retail transactions in which parties have correctly anticipated unconditional FTC clearance, including Men's Wearhouse/Jos. A. Bank, Office Depot/OfficeMax, and Signet/Zale, the acquirer in each case took on a divestiture obligation capped by materiality.

Such provisions, even in instances where parties do not anticipate antitrust issues, provide the seller protection by holding open the possibility of limited divestitures to assuage the FTC in the case of unexpected pushback. The Bass Pro/Cabela's merger agreement, however, would, at first glance, appear to preclude such an outcome. As a result, in the event that FTC staff concludes that the merger would lessen promotional competition in some overlap markets, the issue would appear resolvable only through a Commission decision to reject staff's recommendation and clear the merger unconditionally, or instead, a full-stop injunction.