**COMMERCE COMMISSION****Decision No. 614**

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

ST Cigar Group Holding BV

and

British American Tobacco Plc

The Commission: Paula Rebstock
David Caygill
Gowan Pickering

Summary of Application: ST Cigar Group Holding B.V. sought clearance to acquire all the shares of B.V. Schimmelpenninck Sigarenfabrieken v/h Geurts en Van Schuppen and the cigar trademarks owned by Tabacofina – Vander Elst N.V. that are registered in New Zealand. Henri Wintermans Cigars B.V. will acquire the cigar trademarks of Tabacofina – Vander Elst N.V.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.

Date of Determination: 17 August 2007

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EXECUTIVE SUMMARY

1. The Proposal

A notice pursuant to section 66(1) of the Commerce Act 1986 was registered on 13 July 2007. ST Cigar Group Holding B.V. sought clearance to acquire all the shares of B.V. Schimmelpenninck Sigarenfabrieken v/h Geurts en Van Schuppen and the cigar trademarks owned by Tabacofina – Vander Elst N.V. that are registered in New Zealand. Henri Wintermans Cigars B.V. will acquire the cigar trademarks of Tabacofina – Vander Elst N.V.

2. The Market

The Commission has found that the relevant market for this acquisition is for the importation and wholesale supply of cigars in New Zealand.

3. Counterfactual

The Commission considers that the likely counterfactual would be that the Schimmelpenninck and TVE brands would be acquired by another tobacco company.

4. Competition Analysis

The Commission considers that in the factual scenario, existing competition from Swedish Match and other market participants, and the ability of other players to expand, would be likely to place constraint on the ability of the combined entity to substantially lessen competition.

5. The Commission considers that, in addition, the threat of potential entry would be a competitive constraint in the factual. The Commission considers that the ability of an importing firm to enter the market relatively easily and quickly, within two years, is likely to influence the behaviour of the ST Cigar Group post-acquisition.

6. Overall conclusion

Therefore, the Commission is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in any relevant market.

THE PROPOSAL

1. A notice pursuant to section 66(1) of the Commerce Act 1986 (the Act) was registered on 13 July 2007. The notice sought clearance for ST Cigar Group Holding B.V. to acquire all the shares of B.V. Schimmelpenninck Sigarenfabrieken v/h Geurts en Van Schuppen and the cigar trademarks owned by Tabacofina – Vander Elst N.V. that are registered in New Zealand. Henri Wintermans Cigars B.V. will acquire the cigar trademarks of Tabacofina – Vander Elst N.V.

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a section 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 31 August 2007.
3. The Applicant sought confidentiality for specific aspects of the Application.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

STATUTORY FRAMEWORK

5. Under section 66 of the Act, the Commission is required to consider whether the proposal will have, or would be likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely, if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³
7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is not minimal.⁴ Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

⁴ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.
9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition, such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under section 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
 - with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).
11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual, in terms of:
 - existing competition;
 - potential competition; and
 - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

ST Cigar Group Holding B.V. (ST Cigar Group)

12. ST Cigar Group is a subsidiary of Skandinavisk Tobakskompagni A/S (ST). ST Cigar Group is owned by three groups of shareholders:
 - a Danish company, Skandinavisk Holding A/S which holds 64.71%;
 - a Dutch company Precis (1789) B.V., which is owned by the British American Tobacco Plc, holds 32.35%; and
 - ST employees who control the remaining 2.94% shares.
13. ST trades through various subsidiaries, including Henri Wintermans Cigars B.V. and Nobel Cigars (London) Limited. An ST Cigar Group organisation chart is attached as Appendix One.

14. ST Cigar Group manufactures and supplies tobacco products internationally. It is not involved in tobacco plantation or the raw tobacco trade. ST Cigar Group sells approximately 1.3 billion cigars annually, mostly in Europe and North America.
15. In New Zealand, ST Cigar Group sells its cigars to the importer Stuart Alexander. It is not involved in the importation, wholesaling or distribution of cigars in New Zealand. In New Zealand, ST Cigar Group's well-known brands are Café Crème, Henri Wintermans Founder's Blend and Van Hartog.

B.V. Schimmelpenninck Sigarenfabrieken v/h Geurts en Van Schuppen
(Schimmelpenninck)

16. Schimmelpenninck is a 100% subsidiary of British American Tobacco The Netherlands B.V., which is a 100% indirect subsidiary of BAT Plc. Schimmelpenninck manufactures cigars in The Netherlands.
17. In New Zealand, Schimmelpenninck brands that are sold include: Corona, Panatella, Fresco, Mini Cigar, Swing, and Cubero Mild.

Tabacofina – Vander Elst N.V. (TVE)

18. TVE is an indirect 100% subsidiary of BAT Plc. It manufactures cigars in Belgium, including Corps Diplomatique, Mercator, Let The Glow Carry You, and Sunrise.
19. While the TVE cigar trademarks are part of the Application, BAT Plc discontinued TVE sales in New Zealand in 2005.

British American Tobacco Plc (BAT Plc)

20. BAT Plc is a holding company that owns, directly or indirectly, investments in the numerous companies constituting the British American Tobacco Group of companies. BAT Plc is listed on the London Stock Exchange. BAT Plc and its subsidiaries manufacture and supply cigarettes, cigars and other tobacco products, including brands such as Dunhill, Pall Mall, and Benson and Hedges.
21. In New Zealand, the British American Tobacco Group operates through its indirect subsidiary, British American Tobacco (New Zealand) Limited (BAT). BAT is wholly-owned by British American Tobacco Australia Overseas Pty Limited (an Australian registered company), which in turn is ultimately wholly-owned by BAT Plc.
22. BAT is the largest supplier and importer of tobacco products (mainly cigarettes and roll-your-own or RYO) in New Zealand. BAT also operates a number of subsidiaries in New Zealand, including tobacco distributors. A BAT organisation chart is attached as Appendix Two.

Inter-firm relationships

23. The Applicant, a wholly-owned subsidiary of ST Cigar Group, advised the Commission that it currently has in place several manufacturing agreements with BAT Group. As a result of the global transaction, the Applicant and the BAT Group will enter into another arrangement in which ST Cigar Group will produce cigars (for instance: Captain Black Miniatures) for BAT and undertake other related functions.
24. In addition, the Applicant also advised the Commission that 32.35% of the shares of ST Cigar Group are owned by Dutch company Precis (1789) B.V.

(Precis). In turn, Precis is owned by BAT Group. ST Cigar Group is controlled by ST with the BAT Group having only minority protection rights in relation to its shareholding of ST Cigar Group and the right to nominate two members to ST Cigar Group's supervisory board (which has 12 members in total). The BAT representatives are bound by confidentiality agreements preventing them from disclosing confidential information. These representatives are also not employees or board members of ST Cigar Group.

25. The Commission believes that these relationships do not have any effect in terms of section 47 of the Act.

OTHER PARTIES

Stuart Alexander & Co (NZ) Limited (Stuart Alexander)

26. Stuart Alexander is a privately owned import and wholesaling firm. It operates in New Zealand and Australia.
27. Stuart Alexander is ST Cigar Group's sole customer in New Zealand. It imports and wholesales cigars in New Zealand that it has purchased from ST Cigar Group and from other manufacturers. Stuart Alexander also imports and wholesales one loose tobacco product (Old Holborn), and imports a range of grocery products into New Zealand.

Cigar Manufacturers

28. Currently, there are no domestic manufacturers of cigars. In addition to BAT and ST Cigar Group, a number of other cigar manufacturers also supply their products into New Zealand. These manufacturers supply end-customers through a New Zealand subsidiary or through a local importer. These other manufacturers include:
- Habanos S.A.;
 - Swedish Match A.B.;
 - Agio Cigars GmbH; and
 - Altadis S.A.

Cigarette Manufacturers

29. There are currently firms that import or manufacture other tobacco products, excluding cigars, in New Zealand that also manufacture cigars overseas. These include:
- Imperial Tobacco New Zealand Limited; and
 - Philip Morris International Management S.A.

Cigar Importers

30. In New Zealand, cigar importers either purchase the cigars from the manufacturer or act as an agent. Cigar importers in New Zealand include:
- V. E. Logistics New Zealand Limited;
 - The Pacific Cigar Co. (New Zealand) Limited; and
 - Moderna Trading Co. Limited.

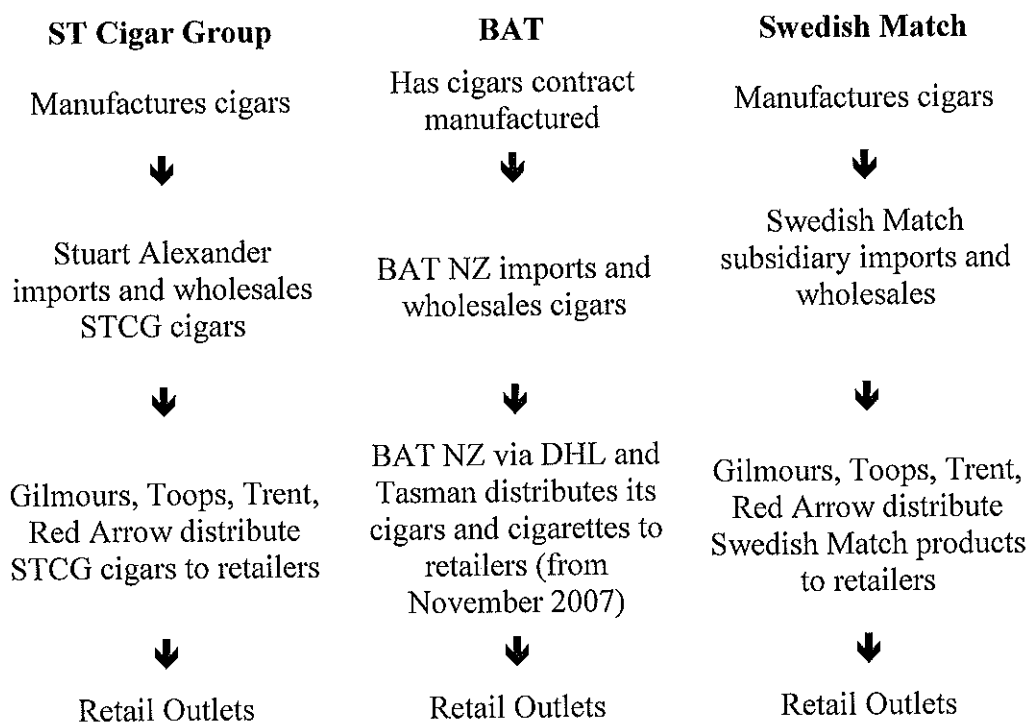
Tobacco Distributors

31. Cigars are typically distributed by specialist tobacco or fast moving consumer goods distributors. These distributors include:
- Red Arrow Limited;
 - Toops Wholesale Limited;
 - James Gilmour & Co. Limited; and
 - Trents Wholesale Limited.

INDUSTRY BACKGROUND

32. Worldwide sales of cigars of all types are estimated to be approximately 15 billion cigars annually. New Zealand sales account for just 0.06% of this, with a little over 10 million cigars being sold here each year. By weight, cigar sales comprise approximately 0.7% of the sales of all tobacco products sold in New Zealand. All cigars sold in New Zealand are imported as there is no domestic production.
33. Cigars are typically sold either by the manufacturer to an importer or by an importer acting as an agent. When an importer purchases the cigars from the manufacturer the ownership of the cigars transfers to the importer. On the other hand, when an importer is an agent, it acts as the representative of the manufacturer, and ownership of the cigars remains with the manufacturer. The importer can be either independent, or a subsidiary of, the manufacturer. The importer then usually either distributes the cigars directly to the retailer or wholesales the products to a distributor who on-sells to retail outlets. Figure 1 shows the supply chain of the Applicant, BAT, and its principal competitor, Swedish Match.

Figure 1: Cigar Distribution Channels



34. At the retail end of the supply chain the majority of cigar sales take place through dairies, superettes, newsagents and tobacconists, which account for approximately [] of sales by volume. Oil companies account for another []. Approximately [] of cigars are sold by liquor outlets with the remaining [] of sales taking place at supermarkets and department stores.
35. The sale of tobacco products in New Zealand is heavily regulated. Advertising of tobacco products is prohibited. In addition, their display in retail outlets is restricted in a number of ways. For example, unless the place of business is a tobacconist's shop, not more than 100 tobacco packages (called "facings") can be exposed for sale at any point of sale.

PREVIOUS COMMISSION AND OVERSEAS DECISIONS

36. The Commission has not previously considered a section 66 clearance Application in the cigar industry in New Zealand. However, in January 1999 the Commission conducted a section 47 investigation into the merger of BAT Plc and Rothmans. BAT Plc and Rothmans International B.V. merged their worldwide interests, including the manufacture and distribution of most of the tobacco products sold in New Zealand. The section 47 investigation led to court action that ended following a settlement agreement between the Commission and the parties on 20 January 2003, under which BAT was to divest a number of cigarette and roll-your-own tobacco brands to a third party unrelated to BAT.
37. The European Commission and the Italian Competition Authority have both considered tobacco industry cases. In Seita / Tabacalera, the European Commission considered that cigars and cigarettes belonged to different markets, because they have very distinct characteristics.⁵ However, the question of whether the cigar market should be further segmented was not addressed.
38. Two other European decisions relate primarily to markets for cigarettes and roll-your-own products and did not discuss cigars explicitly.⁶ Further, all three decisions found that the relevant geographic markets for the tobacco products considered were national in scope.
39. The Applicant applied for regulatory clearance in Portugal for this acquisition. The Portuguese Council of the Competition Authority considered that the post-acquisition concentration would not be able to create or strengthen a dominant position that may hinder effective competition in the relevant market. The Portuguese Council of the Competition Authority considered the relevant market to be the market for the manufacture and wholesale supply of cigars, in the national territory.⁷

MARKET DEFINITION

40. The Act defines a market as:

"... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them."⁸

⁵ Case No COMP/M.1735 - SEITA / TABACALERA 03/12/1999

⁶ Case No IV/M.1415 - BAT / ROTHMANS 17/03/1999 and Case No COMP/M.2779 - IMPERIAL TOBACCO / REEMTSMA CIGARETTENFABRIKEN 08/05/2002

⁷ Portuguese Competition Authority, Ccent. 37/2007 – STCG/ Schimmelpenninck*TVE

⁸ S 3(1) of the Commerce Act 1986.

41. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market and Functional Market

42. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.
43. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
44. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.
45. The Applicant submitted that the relevant product market for the purposes of the current proposal is that of cigars. This was confirmed by industry participants. The Commission accepts that this is the relevant market for the reasons set out below.
46. Cigarettes would not be readily substitutable for cigars for most consumers, even in the face of a significant price increase. Cigars and cigarettes have very distinct characteristics including taste and image. Cigar smoking also tends to be more event related than is cigarette smoking.
47. Although cigars vary greatly in terms of their size, quality and price, there appears to be no clear point at which to segment this market. Stuart Alexander (the New Zealand importer / wholesaler of ST Cigar Group cigars) for example estimates that; small machine-made cigars currently range in price from [] per stick; medium-sized machine-made cigars from [] per stick; and large-sized machine-made cigars from [] per stick. Thus, there are clear overlaps in price and size. The Commission also understands that there is a similar overlap between the prices of machine-made and hand-made cigars. For example, the cheapest hand-made cigars sold by Habanos are around half the price of the most expensive machine-made cigars of ST Cigar Group.
48. From a demand perspective, it is clear, for example, that a premium quality hand-made cigar (perhaps retailing for more than \$100) would not closely compete with a cheap cigarillo (a small machine-made cigar, possibly retailing for even less than \$1). Notwithstanding this, it is likely that the premium hand-made cigar would compete with other cigars at its price level and in the immediately adjacent price level. Therefore, if the price were to rise for this premium hand-made cigar the consumer would be likely to find another premium cigar, hand-made or otherwise, of very similar quality, size and price to be a satisfactory substitute. This overlapping substitutability between cigars at

adjacent quality/price levels would result in a chain of substitutability stretching from the premium cigars to the cheap low quality cigars.

49. On the supply side, the Commission understands that manufacturers of machine-made cigars can readily switch production between small and large cigars as well as adjust quality levels by changing the set-up of machinery and the inputs that they use (such as tobacco). In addition, these manufacturers are able to have hand-made cigars produced for them on contract.

Geographic Markets

50. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers would turn should the prices of local sources of supply be raised.
51. The Applicant submitted that the relevant geographic market for the purposes of the current proposal is that of New Zealand.
52. All cigars that are sold in New Zealand are imported as there is no domestic production. Further, cigars are relatively high value, low weight and low volume products, thus can be transported within New Zealand at relatively low cost. Accordingly, the Commission is of the view that it is appropriate to define the relevant market as being national in extent.

Conclusion on Market Definition

53. The Commission therefore considers the relevant market to be for the importation and wholesale supply of cigars in New Zealand.

COMPETITION IN THE FACTUAL AND COUNTERFACTUAL

54. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).⁹ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

55. In the factual scenario, ST Cigar Group would acquire all the shares of B.V. Schimmelpenninck Sigarenfabrieken v/h Geurts en Van Schuppen and the cigar trademarks owned by Tabacofina – Vander Elst N.V. that are registered in New Zealand. The effect of the proposed acquisition on the market in New Zealand would be that the brand ‘Schimmelpenninck’ would be imported by Stuart Alexander, rather than by the BAT Group.

Counterfactual

56. In the counterfactual scenario, BAT NZ advised the Commission that if the acquisition did not proceed, it would likely either continue to supply the Schimmelpenninck cigar brand in New Zealand or it would dispose of Schimmelpenninck to []. BAT informed the Commission that []

⁹ Air New Zealand & Qantas Airways Ltd v Commerce Commission (No.6), unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.

-].
57. The Commission considers that
[
].
58. The Commission considers that the most likely candidate to acquire the Schimmelpenninck and TVE brands would be another tobacco company,
[
].
59. Accordingly, the Commission considers that the likely counterfactual would be that the Schimmelpenninck and TVE brands would be acquired by another tobacco company.

COMPETITION ANALYSIS

Existing Competition

60. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).
61. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.
62. The Commission considers that a business acquisition is unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exists:
- The three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected persons or associated persons) has less than in order of 40% share; or
 - The three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

Table 1: Market Shares For The Supply Of Cigars In New Zealand (2006)¹⁰

<i>Company</i>	<i>Volume¹¹</i>	<i>Value¹²</i>
STCG	30.16%	[]
BAT (Schimmelpenninck)	23.39%	[]
Combined Entity	53.54%	[]
BAT (retained brands)	>00.01% ¹³	[]
Swedish Match	42.03%	[]
Habanos	1.33%	[]
Agio	0.83%	[]
Altadis	0.33%	[]
10 Others	1.93%	[] ¹⁴
Total	100%¹⁵	100%¹⁶

63. In the factual scenario, the combined entity would have a market share of approximately 53.5% based on volume, and approximately [] based on value. This difference results primarily because of Habanos, a manufacturer that sells relatively few but high value cigars. In the factual scenario, the combined entity's principal competitor would be Swedish Match with 42.0% of the market, based on volume. However, a large number of smaller competitors also would be present.
64. While BAT's market share would be minimal, in terms of its retained brands, the Commission is of the view that the company would have considerable potential to expand its presence. That possibility will be addressed below in paragraphs 66 - 72.
65. In the counterfactual scenario, the Commission considers that the Schimmelpenninck and TVE cigar brands would be sold to another tobacco company.
[] According to Ministry of Health data¹⁷, Schimmelpenninck brand cigars have been declining in market share since 2003, while TVE cigars have not been sold in New Zealand since 2005.

¹⁰ Figures in this table are rounded to two decimal places.

¹¹ Based on data obtained from the Ministry of Health, and calculated from the number of sticks sold in 2006.

¹² Based on the value of sales turnover, as provided to the Commission by industry participants.

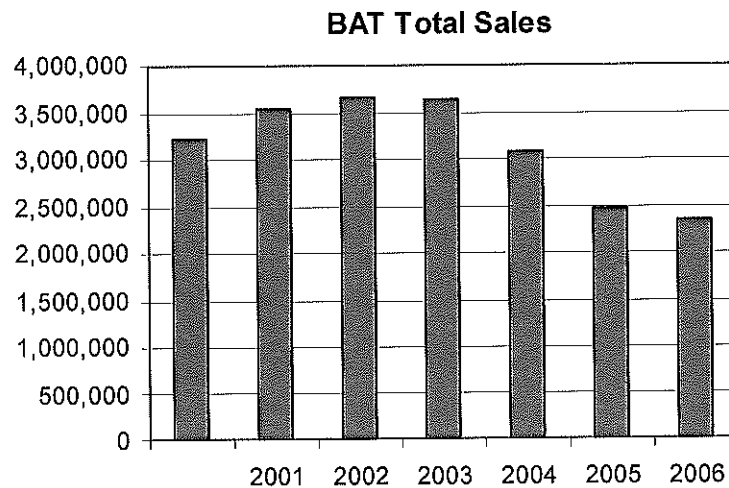
¹³ Actual sales in 2006 were 232 sticks.

¹⁴ Estimated by assuming each cigar in this group is sold at the average price per cigar of those of STCG, Schimmelpenninck, Swedish Match, Habanos, Agio and Altadis.

¹⁵ In total 10,106,306 cigars were sold in New Zealand in 2006.

¹⁶ The total value of these sales was approximately \$10,786,224.

¹⁷ Source: www.moh.govt.nz

Figure 2: Schimmelpenninck Sales by sticks 2001-2006*BAT*

66. BAT advised the Commission that it was unsure as to why the Schimmelpenninck brand had been declining. On the other hand, BAT also advised the Commission that [].
67. A number of industry participants considered BAT's market share had been declining because BAT appeared to have been concentrating on the cigarette side of its business, rather than promoting its cigar brands. The Commission considers it likely that these factors are contributing to BAT's declining market share.
68. In the factual scenario, BAT informed the Commission it would continue its cigarette and roll-your-own tobacco operations and accordingly would remain the largest supplier of these products in New Zealand. Compared to other tobacco product suppliers, BAT is well represented, with a significant number of sales representatives. Industry participants advised the Commission that the primary form of marketing was through the use of "facings" in-store. Facings are the visibility of cigarette and cigar packets on the shelves. Each visible packet is a facing. Each retail outlet organises its own facings. Industry participants advised the Commission that personal relationships between sales representatives and retail outlets were important, in order to influence the number of brand facings visible in-store.
69. BAT also is about to revamp its distribution channels to supply directly to retail outlets using DHL couriers and a call centre based in Australia to take orders from retail outlets. BAT advised the Commission that this will enable it to liaise with customers more often and therefore assist in building relationships with customers.
70. The Commission considers that, with its strong presence in the supply of other tobacco products, BAT would be very well placed to expand its other existing cigar brand in New Zealand, the Dunhill Signed (or Signature Range).
71. BAT informed the Commission that []

]. In addition, BAT could bring in its best selling Australian miniature, the Captain Black, to New Zealand. Captain Black miniatures account for approximately 23% of the Australian cigar market.

72. In the counterfactual scenario, an alternative purchaser might be able to restore the Schimmelpenninck and TVE brands' market share by more actively promoting these brands. Otherwise, the Commission considers that these brands would be unlikely to recover their former market position. In the factual scenario, the Commission considers that BAT is well placed [] to expand its sales of other cigars brands [] in New Zealand. The Commission considers that if ST Cigar Group tried to raise prices, reduce quality or lower its service, then it is likely that BAT would seek to introduce other initiatives, for example, by expanding its cigar brands.

Swedish Match

73. In the factual scenario, Swedish Match would be the second largest manufacturer present in New Zealand, as opposed to the largest in the counterfactual scenario. Swedish Match informed the Commission that it was not surprised that BAT was exiting the cigar market, considering its declining market shares over recent years. Swedish Match considered that if the acquisition went ahead, competition would be stronger from ST Cigar Group (through Stuart Alexander) than it has been from BAT.
74. The Commission considers that, in the factual scenario, Swedish Match would be likely to provide a competitive constraint on ST Cigar Group.

Habanos S.A.

75. Habanos is a joint venture between the Cuban state and Altadis. Habanos is a leading cigar manufacturer which specialises in hand-made premium cigars. It is involved in the production and sale of Cuban tobacco products, especially cigars.
76. Habanos supplies The Pacific Cigar Co (New Zealand) Limited (PCC) with over 30 brands of cigars. PCC has a specialist retail outlet in Auckland, Havana House Cigars. It also wholesales cigars to other outlets including bars, restaurants and cigar retailers.
77. PCC informed the Commission that its sales volumes were increasing and it appears to have considerable scope for future growth, particularly in respect of premium cigars.

Other Existing Market Participants

78. There are a number of other cigar importer/wholesalers, including Moderna (distributing Agio brands among others) and V. E. Logistics New Zealand Limited (distributing Von Eicken cigars). Usually, these products are on-sold to distributors.
79. Although these players hold very small market shares presently, a number of industry players have stated that there is no significant reason why these cigar importers could not grow their sales, were they to commit sufficient resources.

Conclusion on Existing Competition

80. The Commission considers that in the factual scenario, existing competition from Swedish Match, [], and the ability of smaller players to expand would be likely to place a constraint on the ability of the combined entity to substantially lessen competition.

Potential Competition

81. An acquisition that results in the removal of a competitor from a market is unlikely to result in a substantial lessening of competition if the businesses in that market continue to be subject to real constraints from the threat of new entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any impediments they might encounter should they try.

Requirements for Entry

82. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of market conditions that impede entry.
83. The Commission identified a number of entry requirements for supplying cigars in New Zealand. These are:
- compliance with relevant tax, advertising and health warnings;
 - agreement or relationship with cigar manufacturer;
 - at least three sales representatives;
 - storage space; and
 - capital of at least \$500,000.
84. Industry participants advised the Commission that compliance with the relevant tax, advertising and health warnings was relatively straightforward if you had previous industry experience. Industry participants also advised the Commission that the tax and regulations regularly change and are updated annually. Industry participants had varying levels of understanding of the exact compliance necessary, for instance with regards to sales rebates. A number of parties told the Commission that, rather than risk infringing the various restrictions on the sale of tobacco products, they would rather 'err on the side of caution' in this regard and not provide such sales rebates,
85. The Commission considers that the continually changing nature of the industry regulations would mean any new entrant would face similar issues as existing competitors. The Commission does not consider these difficulties are specific to new entry.
86. The Commission does not consider that raising the appropriate amount of capital would be a significant barrier to new entry. The Commission considers that such capital expenditure would not represent a sunk cost for the potential entrant, since exit is unlikely to involve a significant loss in terms of the residual value of the cigars.
87. Industry participants advised the Commission that obtaining suitable storage space was not a significant problem as any warehouse with an air conditioning system could be used.

88. The Commission has not found any significant barriers to prevent new entry. The Commission considers that the ST Cigar Group is likely to be subject to the threat of market entry in the factual scenario. The Commission has, therefore, gone on to assess whether the likelihood, extent and timeliness of such entry, will act as a sufficient constraint on the combined entity in the factual scenario.

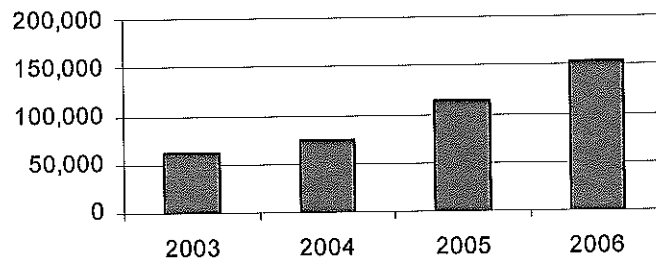
The "LET" Test

89. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:
- 'Likely' in commercial terms;
 - sufficient in 'Extent' to cause market participants to react in a significant manner; and
 - 'Timely', i.e. feasible within two years from the point at which market power is first exercised.

Likelihood of Entry

90. The history of past market entry can be used as an indicator of the likelihood of new entry in the market. There are a number of examples of entry into this market by new brands of existing manufacturers.
91. Stuart Alexander began importing the ST Cigar Group's brand Café Crème Aroma in 2003. Stuart Alexander informed the Commission that it had worked steadily to promote the new cigar [] by []].

Figure 3: Growth of Café Crème Aroma



92. The Applicant submitted that the entry of BAT's Captain Black brand in Australia demonstrates the ability of a brand to enter and then to gain market share rapidly. The Applicant informed the Commission that Captain Black was introduced in Australia in or around 2001. Since then, BAT achieved an increase in its market share from 11% in 2002 to 23% in 2006.
93. The Commission considers that the market in Australia is similar to the market in New Zealand. There are similar entry requirements and health regulations. There are also the same major brands present in New Zealand as Australia and a similar functional supply chain.

94. The Applicant submitted that the most likely entrants would be:
- Imperial with Altadis;
 - Philip Morris; or
 - Gallaher Group and Japan Tobacco Inc with Hamlet.
95. The Applicant submitted that these cigar manufacturers would need only to find a wholesaler to import their cigars and promote them to distributors and retailers. In addition, the Applicant submitted that barriers to entry were not significant and that it was highly likely an entrant would be able to build a brand that retail outlets would be prepared to stock.
96. Imperial does not presently sell cigars in New Zealand. However, it does sell existing Imperial cigar brands overseas and could choose to import these into this country. Imperial informed the Commission that [].
97. Imperial's parent company has been seeking to acquire Altadis, the world's largest cigar company. Imperial considers that the []. Altadis is considered strong in its brands portfolio, its distribution network and its product innovation. It is considered uniquely placed in being able to offer a portfolio of prestige Cuban brands through its 50% holding in Habanos S.A. The Commission understands that the Altadis shareholders recently have approved the sale of Altadis to Imperial. The acquisition is still subject to the approval by the Spanish competition authority.
98. Given the factors outlined above, the Commission considers that in the factual scenario, Imperial would be able to expand into the New Zealand cigar market, and that this ability would be further enhanced should it acquire Altadis.
99. Philip Morris informed the Commission that []. However, Philip Morris also advised the Commission that [].
100. The Commission considers the most likely scenario is that an independent importer would start importing cigars, rather than a manufacturer. Moderna advised the Commission that it would be easy for someone with industry knowledge to set up a cigar importing business. Industry participants advised the Commission that the importer takes all the financial risk and that most major brands would prefer to work that way.
101. Several large international brands are not present in New Zealand, for instance Gallaher Group and Japan Tobacco Inc. with the brand Hamlet. Hamlet is the number one cigar brand in the United Kingdom and has approximately 44% of the European market. The Commission considers that Hamlet could be a likely brand to be imported, as it already has marketing visibility through customers' exposure to it in the United Kingdom.
102. The Commission is of the view that in response to a price increase or other manifestation of market power, entry would be likely from several potential entrants into the market for the importation and wholesale supply of cigars in New Zealand.

Extent of Entry

103. Due to the statutory prohibition of advertising and promotion of cigars, industry participants unanimously informed the Commission that having good sales representatives is the key to developing and expanding business. Industry participants advised the Commission that a potential entrant would need sales representatives to cover the entire country. Stuart Alexander advised the Commission that starting with three sales representatives would be adequate.
104. Based on the experience of previous entrants and the fact that entry requirements are presently not significant, the Commission considers that any new entry would be sufficient in extent to constrain the merged entity.

Timeliness of Entry

105. Industry participants informed the Commission that it would take within a period of six weeks to six months to start importing cigars and that a critical mass of sales could be built within 18 months. The Commission considers, therefore, that entry into the market would be feasible within two years.

Conclusion on Potential Competition

106. The Commission considers that the threat of potential entry would be a competitive constraint in the factual scenario. The Commission considers that the ability of an importing firm to enter the market relatively easily and quickly, within two years, is likely to influence the behaviour of the ST Cigar Group post-acquisition.

Co-ordinated Effects

107. In concentrated markets where competitors regularly interact and other factors are present, competition may be lessened as a result of co-ordinated effects.
108. In broad terms, effective co-ordination can be thought of as requiring three ingredients: collusion, detection and retaliation. What is important is whether co-ordination is more likely, effective and stable in the factual than in the counterfactual. The Commission considers that this is not the case here.
109. While acknowledging the heightened concentration in the market, the Commission considers that co-ordination in this market in the factual would not be likely due to the following factors:
- the wholesale prices of cigars are not transparent;
 - the threat of expansion by smaller players; and
 - the threat of new entry.

OVERALL CONCLUSION

110. The Commission has considered the competition effects of the proposed acquisition, in the market for the importation and wholesale supply of cigars in New Zealand.
111. The Commission considers that the likely counterfactual would be that Schimmelpenninck brand and TVE would be acquired by another tobacco company.
112. The Commission considers that in the factual scenario, existing competition from Swedish Match, [], and the ability of


smaller players to expand would be likely to place constraint on the ability of the combined entity to substantially lessen competition in the market for the importation and wholesale supply of cigars in New Zealand.

113. The Commission considers that, in addition, the threat of potential entry would be a competitive constraint in the factual. The Commission considers that the ability of an importing firm to enter the market relatively easily and quickly, within two years, is likely to influence the behaviour of the ST Cigar Group post-acquisition.
114. The Commission has concluded that it is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in the market for the importation and wholesale supply of cigars in New Zealand.

DETERMINATION ON NOTICE OF CLEARANCE

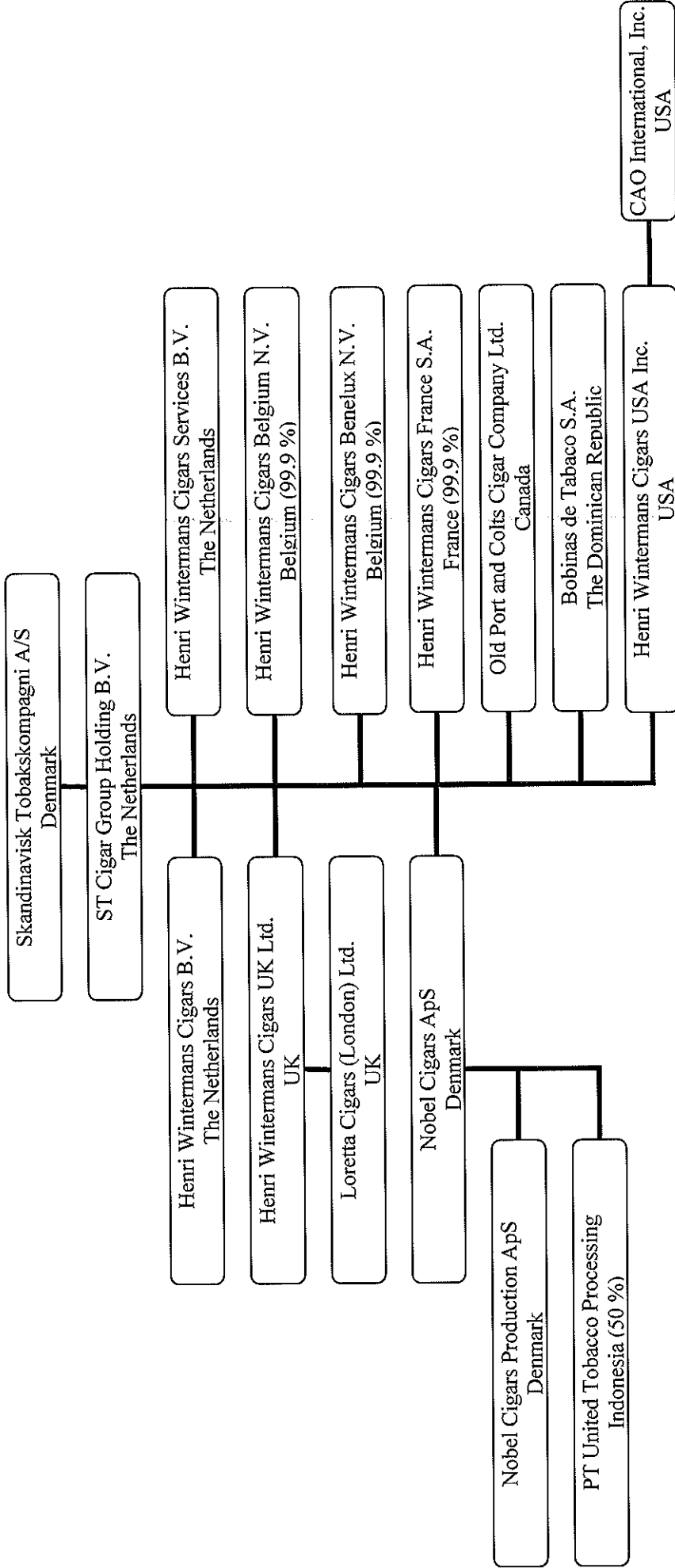
115. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition ST Cigar Group Holding B.V. to acquire all the shares of B.V. Schimmelpenninck Sigarenfabrieken v/h Geurts en Van Schuppen and the cigar trademarks owned by Tabacofina – Vander Elst N.V. that are registered in New Zealand.

Dated *14 September 2007*


Paula Rebstock
Chair
Commerce Commission.

APPENDIX ONE

ST CIGAR GROUP CORPORATE STRUCTURE



APPENDIX TWO

BAT NZ Group Structure as at 5 March 2004

