

PUBLIC VERSION**Daiken / Dongwha: Dongwha International Co., Ltd's submissions on the Commission's Letter of Issues dated 21 December 2017****[Confidential]**

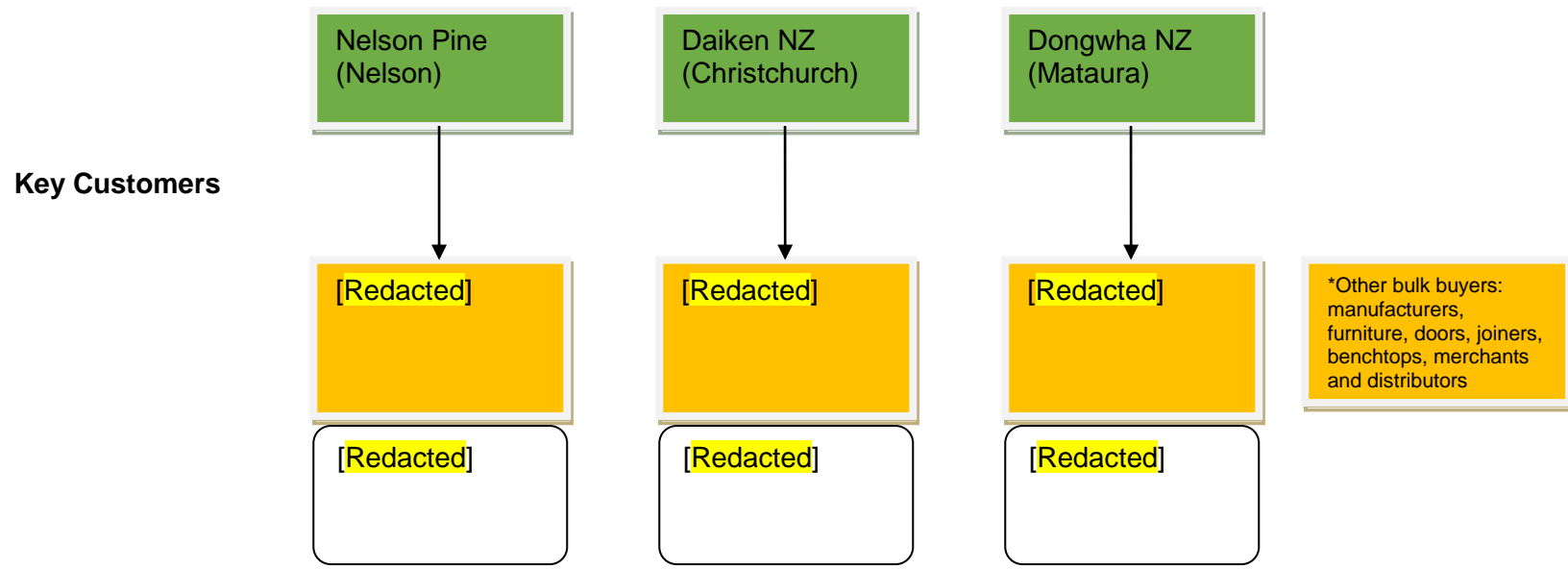
1. Dongwha International Co. Ltd (**Dongwha**) provides these submissions in response to the Commerce Commission's (the **Commission's**) Letter of Issues dated 21 December 2017. These responses are not intended to be a comprehensive articulation of Dongwha's view of the competition law merits of the proposed transaction.
2. It is Dongwha's belief that the transaction would not make coordinated effects any more likely to emerge or make any existing coordinated effects more sustainable or complete. In particular, as Dongwha New Zealand Limited (**Dongwha NZ**) has little impact on competition in the market, the absence of Dongwha NZ from the market will not cause any change to the possibility of co-ordination.
3. Dongwha believes buyers have countervailing power and that in the future, if margins were to increase, there is a realistic risk of new entry by way of imports.
4. Therefore, Dongwha wishes to comment on:
 - 4.1 The existing market.
 - 4.2 The counterfactual.
 - 4.3 The extent to which the market for the manufacture and supply of raw MDF is vulnerable to co-ordination.
 - 4.4 The countervailing power of buyers in the market.
 - 4.5 The likelihood of new entrants in the market via imports.

The existing market

5. In Dongwha's view the market for the manufacture and supply of MDF operates as set out in diagram 1:

Diagram 1: Market for the manufacture and supply of raw MDF in New Zealand

MDF Manufacturers



Downstream Customers

Smaller manufacturers (joiners, furniture, cabinets, doors, benchtops etc).
DIY Consumers buying from hardware stores
Builders buying from hardware stores

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6. Currently the manufacturers of MDF supply to [Redacted] Each of these customers supplies the next level of customer. Due to differences among the MDF manufacturers, they have comparative advantages and disadvantages.
7. We set out in the Schedule to this letter an overview of the MDF manufacturers in the current market, to enable the Commission to understand the similarities and differences between them.
8. [Redacted] Dongwha does not supply to the downstream customers to any significant extent. [Redacted] This supply is so small relative to the overall market as to be trivial.
9. Dongwha's remote location, far from key customers relative to Daiken and Nelson Pine has been a constraint on Dongwha NZ's ability to expand its domestic MDF sales. [Redacted]
10. Effectively, Dongwha does not participate in the downstream market at all. [Redacted].
11. Given that Dongwha NZ sells less than [Redacted]% of its production volume of raw MDF to the domestic market (other than to Laminex) and given its understanding of its areas of competitive disadvantage, Dongwha NZ does not consider itself to be an active competitor in the raw MDF market in New Zealand, and it does not expect any new owner of Dongwha NZ to be any different.

Counterfactual

12. The Commission's preliminary view is that the likely counterfactual is the status quo, where Dongwha NZ remains as an independent competitor either under current or new ownership and continues to compete in the manufacture and supply of MDF in New Zealand. Dongwha believes that in any counterfactual Dongwha NZ will [Redacted].

[Redacted]

13. [Redacted]

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14. [Redacted]

Inability to seriously compete

15. First, Dongwha operates a line for 8-foot MDF panels only. Nelson Pine operates two 8-foot lines and a 6-foot line. Daiken operates a 4-foot and 9-foot line. [Redacted]

16. Second, customers are primarily located in three areas of New Zealand, Nelson, Christchurch and Auckland. With its plant located in Matura, Dongwha is geographically remote from most New Zealand customers. [Redacted]

17. [Redacted]

18. Also, Nelson Pine and Daiken have other competitive advantages, e.g. due to having their own in-house capacity or other locational/operational advantages with respect to certain suppliers and customers, which makes it difficult for Dongwha to be an effective material competitor in the NZ MDF market (see the table in the Schedule). One example is that Dongwha NZ cannot really be an effective competitor in the supply of MDF for mouldings, because of the two main mouldings suppliers in New Zealand:

18.1 one is vertically integrated with Nelson Pine, with its own on-site mouldings facility; and

18.2 the other, Southern Pine, is located in relatively close proximity to Daiken, giving Daiken significant locational advantages

19. Furthermore, a large number of downstream customers require delivery of relatively small volumes to multiple locations and often they demand not only MDF products, but other products related to their business (e.g. hardware, paint etc). [Redacted]

20. The MDF market is not analogous to the market in *Commerce Commission v Woolworths Ltd* in which the High Court accepted the Commission was right to give weight to theoretical concerns raised by a 3:2 merger. In that case the third competitor (Extra) was in the early stage of development.

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The Court found that although Extra was not going to be a price leader, there was a reasonable possibility it would offer a competitive package to which the other competitors would be forced to respond with price reductions.¹ Dongwha is not a developing competitor. [Redacted]

21. [Redacted]

22. [Redacted]

23. Dongwha NZ is not an aggressive or destabilizing competitor now and will not become so in any counterfactual. [Redacted]

24. Apart from supply to Laminex, the market already only has two major competitors (Nelson Pine and Daiken). The situation will be the same after the proposed transaction. The proposed transaction does not result in three competitors becoming two. The same two effective competitors remain in the market.

Difficulties of diverting export volume to domestic market

25. Dongwha understands the Commission is concerned that although it is not a strong presence in the market currently, the ability of Dongwha NZ to divert export product to the domestic market may operate as a disincentive to co-ordination in the market. Dongwha addresses the potential for co-ordination and other constraints below.

26. [Redacted]

27. [Redacted]

28. Because of the significant MDF volumes required by [Redacted], diverting raw MDF supply to either of these entities (Dongwha NZ already supplies Laminex) would involve Dongwha NZ rejecting a number of its stable established export customers. [Redacted]

29. [Redacted]

¹ At [203]

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30. [Redacted] Dongwha NZ's export customers would be forced to buy their MDF from an international competitor if Dongwha NZ diverted exports to domestic sales, and Dongwha NZ would likely lose that customer. [Redacted]
31. Dongwha believes that if prices reached such a level as to provide an incentive for Dongwha to phase out any of its established export supply, that level of prices would also encourage imports to enter the market.

Market not vulnerable to coordination

32. Dongwha does not consider that coordination is currently occurring, will occur in the future, or that the proposed acquisition will make any difference to the likelihood of coordination. There are a number of characteristics suggesting coordination may be difficult.

Lack of transparency of price and volume information

33. Dongwha does not believe that firms in the market have any visibility of each other's prices or volumes. Dongwha has no knowledge of either Nelson Pine's or Daiken's cost of production or pricing. [Redacted]
34. The only potential for learning about competitors' prices is through interactions with customers. [Redacted]
35. [Redacted]
36. Dongwha representatives report that they have observed a different culture around negotiations in New Zealand compared to export customers in other countries. In some export markets, customers readily say what price they can receive from a competitor in an attempt to negotiate a lower price with Dongwha. In New Zealand customers simply make statements such as "I am happy with my current supplier". Dongwha's universal experience is that New Zealand customers do not disclose the prices they can obtain from competitors.
37. There are no industry organization meetings amongst the manufacturers and suppliers of MDF. There are no published price lists. Discounts and

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rebates offered by individual suppliers also make actual prices paid even less visible.

38. [Redacted]

39. Dongwha believes there is a very low level of price and volume transparency in the market for the manufacture and supply of MDF.

40. There are no structural links between Daiken and Nelson Pine that would facilitate coordination between the firms.

Firms do not have similar cost structures

41. The cost of wood fibre and resin /wax cost are the main cost components in raw MDF production, followed by other components such as depreciation, labour costs and logistics / freight cost. Although Dongwha has no specific knowledge, it believes there are differences between Nelson Pine and other suppliers such that the firms are likely to have quite different cost structures. There are a number of reasons why Nelson Pine's costs are likely to be less than any other supplier.² Dongwha would guess (and this is only a guess which the Commission could investigate) that Nelson Pine's costs structures could result in Nelson Pine producing raw MDF for [Redacted]% lower cost than Dongwha NZ:

41.1 Resin is a significant input into the manufacturing process. Nelson Pine is able to pipe resin in from a source very nearby its facility, which Dongwha anticipates would result in cost savings. This is not possible for Daiken or Dongwha.

41.2 [Redacted]

41.3 The capacity of Nelson Pine's plant far exceeds the capacity of Dongwha's Matura plant. Dongwha anticipates that this would enable Nelson Pine to achieve a lower cost per m3.

² See also the table in the Schedule.

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- 41.4 Dongwha believes that the unit labour cost of Nelson Pine is probably lower than Dongwha NZ's. [Redacted] This would remain as a competitive advantage of Nelson Pine even after the merger of Daiken and Dongwha NZ, because the production sites of Daiken and Dongwha NZ are located in different regions. Daiken will not be able to obtain the same economies of scale that Nelson Pine experiences from having all operations on one site.
- 41.5 Transport costs constitute a substantial proportion of the delivered cost of raw MDF. So, in general terms, the closer a MDF manufacturer's plant is to their key customers, the lower the delivered cost will be to that customer. For example, Dongwha understands that Nelson Pine's main customer is [Redacted], which has a facility in Nelson which should result in lower delivered costs.
42. Further, all firms obtain the supply of raw material from different sources. Dongwha believes it cannot be assumed the pricing of the raw material is the same.
43. The firms in the market are also different proximities to key customers. Dongwha's expectation is that Nelson Pine (based in Nelson) would have the lowest freight and related additional costs to supply Auckland. Daiken is next (being located in North Canterbury) with Dongwha NZ (based in Maitua) having the highest freight costs to the biggest MDF market in New Zealand.
44. MDF is sold with relatively small margins. A relatively small difference in cost structure can make a significant difference to the price.
45. Dongwha believes these differences will continue after the proposed transaction and the cost structures between suppliers are likely to remain different. This is likely to make it difficult for the two firms to achieve a coordinated outcome.

Supply shocks

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46. Dongwha believes there is about to be an increase in capacity in both the MDF and particle board market in Australia which is likely to cause such shocks after Q2-Q3 of 2018. As explained in our letter to the Commission on 30 November 2017, Borg (an Australian wood products manufacturer) is about to complete a new particle board line and an upgrade to its MDF line. Dongwha understands that Borg may be increasing MDF and particle board from Q2-Q3 in 2018. We set out below our understanding of Borg's expanding capacity and capacity of other Australian manufacturers.

Manufacturer	MDF Capacity (Total: 650K m ³)	PB Capacity (Total: 1,500K m ³)	Remarks
Alpine	150,000 m ³	-	Acquired Metro from Thailand
Laminex	250,000 m ³	380,000 m ³	
Borg	250,000 m ³	350,000 m ³	<p>MDF Currently under upgrading. Estimated to be expanded by 15% which will increase 6% of MDF production of Australia.</p> <p>PB Acquired from CHH and a new line of 500,000 m³ is commissioning now. PB production of Australia will be increased by 50%. Rapid replacement of MDF to PB is expected. Increase in MDF export and decrease in price are expected accordingly.</p>
D&R Henderson	-	160,000 m ³	
CHH	-	100,000 m ³	

47. Borg currently purchases MDF from other Australian suppliers. When Borg's own upgrade is complete it will no longer make these current levels of purchases. There will be a significant increase in capacity of MDF and particle board³ from Australia. Dongwha believes supply and demand in Australia is currently about level. When MDF production capacity is increased in Australia, suppliers are likely to have excess supply without domestic Australian purchasers.
48. Dongwha believes it is very likely Australian MDF suppliers will look to export markets, including New Zealand, to see if there are any New Zealand customers that can take some of Australia's additional capacity.

³ [Redacted]

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49. The pressure that will exist in Australia to export greater volume of MDF is also likely to place pressure on New Zealand prices. When Borg completes its new particle board line, that additional volume of particle board (as a substitute for MDF in various uses) will replace MDF, resulting in the Australian MDF manufacturers needing to export MDF in order to sell existing production volumes of MDF.

Specific applications and relationships

50. There are differences in MDF required for specific applications. These differences and established relationships between market participants create different advantages for different producers in respect of the different applications. This significantly reduces the ability of the MDF suppliers to coordinate.

51. As the Commission is aware from Daiken's application and its own investigations, raw MDF is mainly used for mouldings, bench tops, door surfaces and cabinets in the New Zealand market.

52. First, in relation to mouldings, Dongwha understands that Daiken has a close relationship with [Redacted] in relation to the mouldings business, and Nelson Pine has its own production line for mouldings. [Redacted] Given that Nelson Pine has its own mouldings business and that Daiken has an existing close relationship with [Redacted], the proposed acquisition of Dongwha NZ by Daiken would not change the situation in relation to mouldings customers. So, there is no incentive for coordination in relation to mouldings customers.

53. Secondly, in regard to benchtop manufacturers, Dongwha's understanding is that Nelson Pine has the majority of the share in this space, [Redacted]

54. Thirdly, in relation to door surfaces, [Redacted] As described above, this market structure and these relationships significantly reduce the incentive for MDF manufacturers to coordinate on pricing.

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55. Finally, cabinet makers are the biggest volume buyers of MDF, but the incentive for coordination in respect of these customers is low, because it is easy to replace MDF in these applications with Particleboard. [Redacted]

Countervailing power of purchasers

56. Dongwha believes the [Redacted] domestic raw MDF customers [Redacted] are all sophisticated purchasers with significant countervailing power that could be exercised in the event domestic prices rise to any significant extent. These customers have visibility of export prices, [Redacted]. These customers are not just substantial buyers of raw MDF, but they are also substantial buyers of many other wood products. [Redacted]. By buying large volumes of various products, including raw MDF, these large distributors have substantial buying power and therefore countervailing power over MDF suppliers. They are unlikely to allow domestic prices to increase disproportionately to export prices without reasonable justification.
57. [Redacted]
58. [Redacted] all have the ability and experience to resort to imports if necessary. Dongwha refers to the Commission's comments in the letter of issues that New Zealand MDF customers consider more than price when deciding whether to import (i.e. quality, warehousing, delivery timing etc). This may be true to some degree for smaller downstream buyers of MDF, but Dongwha does not consider that such factors would be material hurdles to [Redacted]
59. The removal of Dongwha will not affect the bargaining power of [Redacted]. The geographical location of the suppliers and [Redacted] customers and the relationships between those players means Dongwha is unable to seriously compete [Redacted] This is the position now and remains the position in any counterfactual.
60. The removal of Dongwha NZ will also not affect the bargaining power of the downstream customers as Dongwha NZ has very limited interaction with any other New Zealand customers.

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61. The significant countervailing power of purchasers provides an effective constraint on any increase in co-ordination in the market.

Entry into the market by imports

62. If NZ domestic prices increase significantly, it is very likely manufacturers in Australia, South Korea, South America, or Eastern Europe will begin to take an interest in the New Zealand market. All of these countries make MDF from pine and could supply substitutes for MDF manufactured in New Zealand.
63. Dongwha believes that if it becomes viable for Dongwha NZ to ship raw MDF by container to Auckland, it will also likely be viable for foreign suppliers to ship raw MDF to Auckland. [Redacted]
64. The large consumers of MDF import, warehouse and distribute other products currently. [Redacted] Dongwha believes that it would not be difficult for any entity to apply their resources and experience to importing raw MDF.
65. If prices rise above a competitive level, Dongwha believes [Redacted] would pursue imports and suppliers outside New Zealand would be more than willing to supply those imports.

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	Nelson Pine	Daiken NZ	Dongwha NZ
Location	Nelson	Rangiora, North Canterbury	Mataura, Southland
Plant type	8 foot x 20M Conti, Kuster (80,000 m3) 8 foot x 27.9M Conti, Kuster (170,000 m3) 6.4 foot x 27M Conti, Kuster (100,000 m3)	4 foot (flexi) x 24 foot, 10 openings (115,000 m3) 9 foot (flexi) x 18.5M Conti (105,000 m3)	8 foot x 28.06M Conti, Kuster (180,000 m3)
Cut to size facilities	On-site	On-site	No facilities on site, so cannot produce "handipanel" products.
Annual MDF production capacity	c. 300,000 - 350,000 m3 (estimated)	c. 220,000 m3 (estimated)	c. 200,000 m3
Employees	c. 210 (including forestry and LVL sector)	Unknown	c. 130
Resin supply	Pipeline from neighbouring site (advantage)	External supplier located in Christchurch	External supplier located in Christchurch
Wood Supply	Owns forests and understood to also have third party suppliers (advantage).	Third party suppliers.	Third party suppliers.
Age of plant / depreciation situation	MDF production started in 1986. Second line: 1991. Third line: 1997 ⁴ . Depreciation unknown, but plant established earlier, so possibly little to no remaining depreciation (advantage).	Plant built 1976. Second line: 1994. Depreciation unknown, but plant established earlier.	Production start 1997. Depreciation ongoing.

⁴ <http://www.nelsonpine.co.nz/company/profile/>

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Largest Customer of Manufacturer / Location	[Redacted]	[Redacted]	[Redacted]
Other customers of manufacturer	Mitre 10, ITM, Carters, Impeys, Shearers, Bay Panel & Hardware Supplies Ltd, Gunnensen, Placemakers, Laminex, IBS and Scooters Plywood and Joinery. ⁵	See Application ⁶ .	[Redacted]
Distance to Auckland	850km (advantage over others)	1,036km (advantage over Dongwha NZ)	1,576km
Standard truck rates to Auckland⁷	\$4,825 per truck, which is \$130 / m3 (advantage over others)	\$5,662 per truck, which is \$153 / m3 (advantage over Dongwha NZ)	[Redacted]
Example sea freight to Auckland	Unknown	Unknown	[Redacted]
Export freight rates	Unknown	Unknown	[Redacted]
Customers / Usage: Below is Dongwha's understanding of key customers of the manufacturers, the use the raw MDF is put to and known relationships.			
Melamine MDF	[Redacted]	[Redacted]	[Redacted]
Moulding	[Redacted]	[Redacted]	[Redacted]
HPL (High Pressure Laminate) Benchtop	[Redacted]	[Redacted]	[Redacted]
Doors	[Redacted]	[Redacted]	[Redacted]

⁵ Application, para 10.15

⁶ Application, paras 8.15 – 8.18

⁷ [Redacted]

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Lamination	[Redacted]	[Redacted]	[Redacted]
Handipanel	[Redacted]	[Redacted]	[Redacted]