

COMMERCE ACT 1986: BUSINESS ACQUISITION

SECTION 66: NOTICE SEEKING CLEARANCE

2 August 2006

The Registrar
Business Acquisitions and Authorisations
Commerce Commission
PO Box 2351
Wellington

Pursuant to section 66(1) of the Commerce Act 1986 notice is hereby given seeking *clearance* of a proposed business acquisition.

EXECUTIVE SUMMARY

- A Godfrey Hirst NZ Limited or any interconnected body corporate thereof (*Godfrey Hirst or the Applicant*) seeks clearance to acquire some or all of the assets of Feltex Carpets Limited (*Feltex*) (the *Acquisition*).
- B Feltex, once a market leader, has been battered by a contraction in the building and renovation market. In the absence of a major capital injection the iconic brand faces an uncertain future.
- C The Acquisition would result in some aggregation in the markets for:
- (a) wool scouring services in the North Island; and
 - (b) the supply of carpets in New Zealand.

Both markets are keenly contested, characterised by significant existing domestic participants, fluid international trade and price sensitive acquirers.

- D The Acquisition will ensure that the Feltex brand remains both in local and export markets. The Applicant has the financial resources and industry knowledge to realise synergies and efficiencies that will re-invigorate the competitive process.
- E Indeed, the Acquisition should have a pro-competitive effect in both wool scouring and carpet markets. The financial position in which Feltex now finds itself reflects a currently inefficient and fragmented industry. The Acquisition will consolidate industry specific assets to provide a market structure that will incentivise productivity increases and ensure the future of a contested carpet industry.

PART I: TRANSACTION DETAILS**The Business Acquisition**

- 1 The acquisition by the Applicant of some or all of the assets of Feltex.
- 2 The details of the transaction are set out in the Letter Agreement between Godfrey Hirst and Feltex, dated 1 August 2006, attached at **Appendix A**.
- 3 Feltex has not participated in the preparation of this Application. The Applicant to date has relied upon its own knowledge of the industry and publicly available information.

The person giving notice

- 4 This notice is given by:

Godfrey Hirst NZ Ltd
142 Kerrs Road
Wiri
Auckland

Telephone: +64 9 268 3300
Facsimile: +64 9 268 3311
Attention: Tania Pauling, NZ General Manager

- 5 All correspondence and notices in respect of this application should be directed in the first instance to:

Chapman Tripp
1-13 Grey Street
PO Box 993
Wellington

Telephone: +64 4 499 5999
Facsimile: +64 4 472 7111
Email: grant.david@chapmantripp.com
Attention: Grant David

Confidentiality***The fact of the proposed acquisition?***

- 6 Confidentiality is not required for the fact of the proposed acquisition.

Specific information contained in or attached to the notice

- 7 Confidentiality is requested for all the information deleted from the attached "public version" of this notice on the grounds that the information is commercially sensitive to the Applicant. Disclosure of such information would be likely to unreasonably prejudice the commercial position of the Applicant in terms of section 9(2)(b) of the Official Information Act 1982.

Details of the Participants

Feltex

- 7.1 Feltex is a vertically integrated manufacturer of carpets in New Zealand and Australia. Details about the business activities of Feltex are set out in paragraphs 10.1 to 10.5 below.
- 7.2 Further information on Feltex's business activities (including a copy of the 2005 annual report) is available at www.feltex.co.nz.

Shareholders

- 7.3 Feltex is listed on the New Zealand Stock Exchange. A list of the top 20 shareholders in Feltex, as at 14 July 2006, is attached at **Appendix B**.

Subsidiaries

- 7.4 A structure chart for Feltex is provided and attached at **Appendix C**. Feltex's subsidiaries are detailed and listed at **Appendix D**.

8 Godfrey Hirst

- 8.1 The McKendrick family (and their related interests) ultimately own the Applicant and Godfrey Hirst (Australia) Pty Limited (*GHA*). Both companies are vertically integrated manufacturers of synthetic and woollen tufted carpets (in New Zealand and Australia). The relevant corporate structure chart for the Applicant and its related group of companies (*Godfrey Hirst Group*) and *GHA* and its related group of companies (*GHA Group*) are set out and attached at **Appendix E** and **Appendix F** respectively.

Godfrey Hirst Group

- 8.2 Godfrey Hirst is a vertically integrated carpet manufacturing and wool processing company, based in Auckland, with operations in both the North and South Islands of New Zealand. The Godfrey Hirst Group primarily produces woollen carpets for the residential and commercial sectors of the flooring market in New Zealand and for export. Details about the business activities of Godfrey Hirst are set out in paragraph 10.5 below.
- 8.3 99.99% of Godfrey Hirst's share capital is held by Avon Pacific Holdings Limited (*APHL*), with the remaining 0.01% held by Truenom Limited. *APHL* is wholly owned by Olympic Pacific Limited (*OPL*), a company registered in Vanuatu. *OPL* is 100% owned by McKendrick family interests. A breakdown of GHNZ subsidiaries and their principal activities are detailed and listed at **Appendix G**.

GHA Group

- 8.4 The GHA Group manufactures synthetic and woollen tufted carpets in Australia. GHA is 98% owned by Rata International Pty Limited (*Rata*), with the remaining 2% owned by Lyndsay Sharp (nee McKendrick). Rata is owned by interests associated with the McKendrick family, and Rudyard (Kim) McKendrick is Chairman and CEO of the Godfrey Hirst Group. A breakdown of Godfrey Hirst Group and GHA Group of subsidiaries and their principal activities are detailed and listed in **Appendix G**.

9 Formal and informal links between participants

- 9.1 As far as the Applicant is aware there are no formal or informal links between the parties or any interconnected persons in either market. However, we note that the Applicant sold a shareholding in Feltex in March this year.

Directorships

- 9.2 None of the relevant parties holds any directorships in another party that are of significance to the current application.

10 The business activities of each participant (and interconnected and associated parties)*Feltex*

- 10.1 Feltex has been operating as a carpet manufacturer in New Zealand since the 1940s, and spread to Australia in 2000 when it acquired Shaw Industries Australia from Shaw Industries Inc., the world's largest carpet manufacturer. Feltex employs approximately 800 people in New Zealand.
- 10.2 The vertically integrated Feltex operation includes a wool scouring plant, five spinning mills, three tufted carpet mills, a woven carpet mill, two distribution centres and offices in New Zealand, Australia and the United States.
- 10.3 In New Zealand, Feltex manufactures tufted and woven wool carpets. It also produces wool yarns for its own use in New Zealand, for export to its Australian production facilities, and for sale to overseas carpet producers. Feltex also scours wool for its own use and commission scours wool for other wool exporters. Approximately 60% of Feltex's total New Zealand carpet production is exported to and sold in Australia.¹
- 10.4 In Australia, Feltex produces wool and man-made fibre and manufactures tufted wool and man-made fibre carpets.

¹ Feltex Carpets Limited, Investment Statement and Prospectus, 5 May 2004.

Godfrey Hirst Group

- 10.5 The Godfrey Hirst Group is a vertically integrated carpet manufacturer with operations in both the North and South Islands of New Zealand. The Godfrey Hirst Group produces carpet for a range of end uses, including, houses, apartments, office buildings, retail shops, the hospitality, education, and healthcare sectors, and entertainment complexes.
- 10.6 In addition to manufacturing of carpets through Godfrey Hirst, the Godfrey Hirst Group processes wool for wool exporters through Clifton Wool Scour Limited (CWS) and sells yarn to GHA in Australia through Canterbury Spinners Limited (CSL).
- 10.7 The Godfrey Hirst Group operates a yarn spinning mill, two wool scouring and dumping plants, two wool dumping operations and one tufted carpet mill. In total, the Godfrey Hirst Group employs more than 500 people throughout New Zealand.
- 10.8 The GHA Group is a vertically integrated manufacturer in Australia of synthetic and woollen tufted carpets.

11 ***The reasons for the proposal and the intentions in respect of the acquired or merged business***

Feltex

- 11.1 Feltex carpets are well recognised and the company has been successful both domestically and abroad. However, Feltex has not fared well in recent times, suffering from the recent downturn in construction and having to re-establish strained business relationships with key acquirers. Feltex's future as a continuing brand looks dire unless it somehow sources much needed capital. Its financiers are threatening insolvency action, as was recently reported:

The iconic New Zealand carpet manufacturer's bankers have given it until the end of September to find a rescuer and lift its earnings to cover debt and avoid collapse, after it breached its banking covenants last month. Analysts estimate the company needs an injection of \$20 million to \$60 million.²

- 11.2 The Acquisition will restore the brand's credibility. The Applicant will ensure that the assets continue to produce the Feltex brand, while also seeking to realise productive efficiencies through increased economies of scale, and productivity gains (and innovation generally), which will reinvigorate the competitive process.

² "Feltex 'failed to see looming changes'" Andrea Fox, Herald on Sunday, July 16, 2006.

Godfrey Hirst

- 11.3 While Godfrey Hirst is a leader in the New Zealand domestic marketplace, increased import competition has seen its own market share decline (and future tariff reductions are likely to exacerbate this loss). Godfrey Hirst, as a result of the Acquisition, intends to realise significant efficiency gains, which will lower its cost base, and, due to the competitive threat of alternative manufacturers, result in lower prices to customers.
- 11.4 The Acquisition will also resolve Feltex's looming financial deadline and also yield:
- (a) better utilising production capacity by increasing throughput for yarn production, and increasing production through a smaller number of production facilities;
 - (b) reducing costs by combining production, management and sales forces to eliminate unnecessary duplication of activity;
 - (c) providing for the consolidation of expertise; and
 - (d) freeing capital necessary for R&D expenditure of sufficient amount and duration to remain competitive in domestic and international markets.
- 11.5 The Commission's *Mergers and Acquisitions Guidelines* stipulate that the Commission may, in assessing the counterfactual, consider whether the business to be acquired is a "failing firm". According to recent company announcements, Feltex is in breach of its lending facility covenants and successful capital raising is now necessary to ensure survival of the Feltex brand. The Applicant intends to continue to aggressively promote the Feltex brand, thereby ensuring that consumers continue to enjoy the current range of options in the marketplace. The Applicant believes that if it were not to acquire Feltex's assets, another existing market participant would. But, in doing so, that competitor would simply absorb the assets and discontinue the brand. Alternatively, it is likely the assets would be sold to an overseas manufacturer and lost entirely to the New Zealand market.
- 11.6 In contrast, Godfrey Hirst's intention is to combine the existing strengths of both firms. It plans to reinvigorate the brand, realise efficiencies (thereby lowering its cost base) and provide price leadership in the market.

11.7 PART II: IDENTIFICATION OF MARKETS AFFECTED

12 Horizontal Aggregation

12.1 The markets principally affected by the Acquisition are:

- (a) *Wool scouring services in the North Island*: The merged entity will control approximately []% of the market for wool scouring services in the North Island, and, on a national basis, will account for approximately []% of wool scouring services.
- (b) *Supply of carpet in New Zealand*: The merged entity will control approximately []% of the market for the supply of carpet in New Zealand.

Each of these markets is considered in detail below. The Acquisition will not result in aggregation in any other markets.

The market for wool scouring services in the North Island

Introduction

13 The Acquisition will result in the aggregation of wool scouring services in the North Island.

Market definition

14 *Product Market*

- 14.1 Wool processing can generally be divided into two categories – dumping and scouring. Once raw wool has been sheared from sheep, it is either dumped or scoured.
- 14.2 Wool dumping involves compressing and packing several bales of greasy wool into tighter bales that can be packed in shipping containers for export and further processing overseas. The dumping process thus reduces freight costs.
- 14.3 Wool scouring is the process used to clean the wool to remove grease and dirt. After washing and drying the scoured wool is repackaged for delivery for further processing. Generally speaking, about []% of wool is said to be scoured and the figures in **Appendix H** bear this out – a total of [] bales of [] produced in New Zealand in 2005, were scoured.
- 14.4 In addition to wool scouring and dumping, there are ancillary wool processing services sold such as wool blending, dag crushing and fertiliser manufacturing. These services account for less than []% of total wool processing sales in New Zealand.
- 14.5 Thus, while on the supply side producers are able to either scour or dump their product (or supply some other minor ancillary processor), that

decision is largely dictated by exogenous international prices. The appropriate product market for assessing the competitive impact of the Acquisition is that for wool scouring services (albeit recognising that alternative options for suppliers provides some competitive constraint).

15 *Functional Market*

- 15.1 The customers of the wool processor retain ownership of the wool throughout the dumping or scouring process – that is, the processor itself does not purchase the wool and has little influence on the process undertaken. Thus, on the demand side, there is a high degree of substitutability between the dumping and scouring processes in New Zealand, but those processes are functionally distinct – albeit interdependent.
- 15.2 The Applicant considers that the relevant functional market is wool scouring services.

16 *Geographic Market*

- 16.1 The Applicant considers that the relevant geographic market is the North Island.
- 16.2 Historically, wool scours have been located within or in close proximity to the major wool producing areas of each Island in New Zealand. Even today the remaining North Island scours are located in the Hawkes Bay and Manawatu regions, and while there is considerable movement of wool bales between regions for scouring, that movement is generally confined to the relevant Island. In the past, up to []% of greasy bales may have been transported from the North Island to the South Island for scouring, but increased transport costs are said to have reduced this movement more recently. Again, the figures in **Appendix H** bear this out, with a mere [] of [] North Island bales, or []%, travelling inter Island.

Parties involved in wool scouring

- 17 Wool scouring involves commercial customers (licensed wool exporters based in New Zealand) buying the services of scouring from operators, and terms and conditions of sale are negotiated between the scourer and the exporter. Generally, an exporter will choose scouring operators that can provide a one-stop shop for the full range of wool processing services (e.g. scouring, blending and dumping), high quality processing, and competitive pricing.

Differentiated product markets

- 18 As discussed at paragraph 15.1 above, there is a high degree of substitutability between the wool processing services. These services are therefore differentiated for the purposes of this market analysis, and the market figures for dumping are included under “Greasy exports” in **Appendix H**.

The market for supply of carpets within New Zealand

Introduction

- 19 The merger will result in the aggregation of market share in the supply of carpets in New Zealand.

Market definition

20 *Product market*

- 20.1 Both the Applicant and Feltex manufacture carpets made from either wool or man-made inputs, such as nylon and polypropylene. Thus, there may be some basis for a woollen carpet / synthetic carpet distinction. In practice, however, while consumers may have a preference for either a wool or synthetic carpet, most will consider both options along the chain of substitutability. The physical similarities between both types of carpet, and the willingness of consumers to substitute between them (given a sufficient price incentive), suggest the appropriate product market comprises all carpets.

- 20.2 Conversely, there is an argument that the market is broader – including other floor coverings (such as vinyl, ceramic tiles and wood) – with carpets comprising only one segment of that broader market. That argument may be stronger in warmer climates and/or countries where central heating of homes and commercial buildings is the norm. Certainly, carpet increasingly must compete with other surfaces in the same floor space.

- 20.3 However, we do not think that a broader definition of the product market would aid competition analysis in this instance. But, we recognise that the position may well be different in geographic areas where, or among particular groups of buyers for whom, non-carpet flooring is prevalent.

21 *Functional market*

- 21.1 The relevant functional level is between manufacturers (such as Godfrey Hirst) and independent retailers (such as Carpet Court and Flooring First) and other intermediaries (including interior designers, architects and general flooring firms).

22 *Geographic market*

- 22.1 As stated above, distribution occurs mostly through independent retailers. Retailers demand carpets on a national basis and ensure that manufacturers distribute on a national level. In addition, prices are broadly equivalent throughout New Zealand, indicating that the appropriate geographical market is New Zealand wide.

23 *Customer market*

- 23.1 There are arguments to suggest that the carpet market could be split into separate residential and commercial carpets sales markets. Those arguments are stronger where the scale or nature of operations means there is different treatment of different customer groupings. In New Zealand, however,

supply-side features indicate little, if any, differentiating factors in the production and sale to residential and commercial customers.

- 23.2 The appropriate market for competition analysis in this case is the market for the supply of carpets within New Zealand.

Parties involved in the market for supply of carpet

24 *Manufacturers*

- 24.1 A summary of the Applicant's manufacturing process for carpet is attached as ***Appendix J***.

- 24.2 In addition to Godfrey Hirst and Feltex, the main carpet manufacturers in the New Zealand industry are Cavalier Bremworth Limited (*Cavalier*) and Norman Ellison Carpets Limited (*NE*), with a number of importers of carpet occupying the remainder of the market.

25 *Distributors*

- 25.1 Distribution channels to facilitate commercial carpet sales involve the networking of sales professionals with key influencers and decision makers. The two primary influencers are Interior Designers and Architects. These influencers (also known as specifiers) nominate the carpet to be installed in commercial projects. Secondary influencers such as Project Managers or Quantity Surveyors may change these specifications. Once the decision on carpet has been agreed, subcontractors are commissioned to order the carpet. Other discretionary or non-specified sales of commercial carpet are channelled via carpet retailers.
- 25.2 Residential carpet sales are made via a network of retail and marketing groups including Carpet Court, Flooring First, Jacksons, Floorpride, and Hubbers, and also by a number of independent retailers throughout New Zealand.

Differentiation

- 25.3 As discussed above at paragraph 20.1, there is limited product differentiation between wool and synthetic fibres. Price and individual preference are the primary determinants.

Vertical integration

- 26 The proposed transaction will not result in any additional vertical integration in the carpet industry. However, the Applicant notes that the businesses of both parties already operate on a vertically integrated basis and as such encompass wool scours, spinning mills, woven carpet plants and tufted carpet mills.

27 Previous acquisitions***Feltex***

27.1 To the Applicant's knowledge, Feltex has not undertaken any acquisitions in the last three years.

Godfrey Hirst

27.2 Godfrey Hirst has not undertaken any acquisitions in the last three years.

PARTS III, IV AND V: COMPETITION ANALYSIS

- 28 In order to simplify the Commission's analysis, the Applicant provides below consolidated information relating to Parts III, IV and V of the notice for both markets identified in Part II.

WOOL SCOURING SERVICES IN THE NORTH ISLAND

Constraints on market power by existing competition

29 *Existing competitors*

- 29.1 The most recent market share figures for wool scouring services in the North Island are:

Firm	Annual Production (bales)	Market Share
CWS (GHNZ)	[]	[]%
Feltex Kakariki	[]	[]%
Merged Entity	[]	[]%
HBWS (Cavalier)	[]	[]%
Whakatu (NZWS)	[]	[]%
Total	[]	100%

Note: Figures relate to year ended 2005. [] bales were transported to the South Island and approximately [] "greasy" bales were exported.

Competing scourers

- 29.2 The North Island market is characterised by four large players, of which two will remain in the market following the Acquisition. The ability of acquirers to continue to source from those competitors (and, to a lesser extent, the South Island) will constrain the merged entity in the factual.
- 29.3 At present, three scours, which are all vertically integrated with a carpet manufacturer (CWS, Hawkes Bay Wool Scourers (HBWS) and Feltex), compete with each other and with another scour (New Zealand Wool Services International Limited (NZWS)) which is not integrated.
- 29.4 In particular, the two substantial scourers, HBWS and NZWS, will remain in the factual:

- (a) HBWS is 92.5% owned by Cavalier, and holds the largest scour in the North Island based in Napier. Its production of [] bales, comprising []% of North Island production, will not be adversely affected by the proposed merger.
- (b) NZWS is a publicly listed company that owns and operates the Kaputone Wool Scour in Christchurch and the Whakatu Wool Scour in Napier. It has recently completed an upgrade of scour at Whakatu, increasing its capacity from approximately []% of the market in 2003 to []% presently.
- 29.5 The merged entity will combine the current production and capacity of CWS and Feltex, their production for the 2005 season being [] bales ([]%) and [] bales ([]%) respectively. A simple focus on aggregation of market-share, however, would misrepresent the competitive dynamics of the market post-acquisition. Firstly, the Feltex scour at Palmerston North is regarded as requiring an upgrade and being costly to run due to its location. Secondly, any merged entity may be expected to encounter some adverse reaction from growers, and vigorous responses from its rivals.
- 29.6 In any event, two efficient, well positioned and vigorous competitors will remain with market shares of []% (HBWS) and []% (NZWS). Of these two competitors, one is similarly vertically integrated with a well positioned, single site plant; and the other has a recently expanded plant with surplus capacity.
- 30 **Conditions of expansion by existing competitors**
Capacity for production
- 30.1 The merged entity will continue to be constrained by the threat of expansion by existing scourers. NZWS has upgraded its scour at Whakatu in the Hawkes Bay to increase capacity and run cost-effectively. Such increased capacity from the Whakatu plant is reflected in the figures in **Appendix H**. NZWS's actual production for the 2003 season was [] bales, comprising []% of North Island production. That may be compared with its [] bales, comprising []% of North Island production, for the 2005 season.
- 30.2 The ability of NZWS to expand its plant in a timely and cost effective manner indicates the low barriers to expansion in the market. NZWS could further expand production should the merged entity seek to impose a SSNIP in the future.
- Coordinated market power**
- 31 There is minimal scope for collusion in the market for wool scouring services. Referring to the Commission's *Mergers & Acquisitions Guidelines*, the market has the following features:

- (a) a high degree of competition will remain in the market, with fragmented participation;
- (b) a degree of product differentiation;
- (c) the market is dynamic;
- (d) new entry can occur;
- (e) neither firm is a maverick business in the market;
- (f) there is no history of collusive conduct in the market for wool scouring services. Traditionally, it has been highly competitive; and
- (g) exporters are savvy and sophisticated, and have a degree of countervailing power.

Countervailing power of exporters

- 32 A significant constraint on the merged entity's wool scouring operations is the ability of exporters (as customers) to switch between scourers.
- 33 Wool scouring customers in New Zealand consist of approximately forty licensed wool exporters. These exporters sell scoured wool to the carpet, apparel and bedding industries both within New Zealand and overseas. Licensed wool exporters also broker transactions in relation to the export of blended and dumped wool.
- 34 Any attempt to increase prices for wool scouring will be met with vociferous protest from exporters, which would damage the merged entity's brand and reputation generally. Exporters are sophisticated commercial operators, and will not hesitate to switch custom in respect of other aspects of the merged entity's business, such as dumped or blended wool. The continuing presence of other major participants in the market post-acquisition, (together with the ability to expand capacity) will act to provide wool exporters significant countervailing power over the merged entity.

Conclusion on wool scouring

- 35 Despite the proposed merger aggregating the market shares of Feltex and Godfrey Hirst, the market will continue to be characterised by two significant existing competitors (both vertically integrated and stand-alone) and savvy, price sensitive customers, who together will continue to constrain the merged entity. The differing characteristics of these two competitors suggest that the proposed acquisition is more likely to result in a stimulation of competition (rather than any lessening). Further, as NZWS's recent behavior has shown, barriers to expansion, in practical terms, are readily surmountable.

- 36 Accordingly, the proposed merger will not lead to a lessening of competition in the market for wool scouring services in the North Island.

SUPPLY OF CARPET IN NEW ZEALAND

Constraints on market power by existing competition

- 37 ***Existing Competitors***
- 37.1 Similar to the market for wool scouring, the presence of major competitors, import competition and the ability of local participants to divert export to the domestic market will significantly constrain the merged entity post-acquisition.
- 37.2 The Applicant estimates that Cavalier and NE enjoy market shares of []% and []% respectively. In addition, the Applicant contends that the substantial volume of imports – currently estimated at []% (excluding Godfrey Hirst imports) – must be considered as part of any analysis of this market.
- 37.3 The Applicant believes that both Cavalier and NE are capable of increasing production within a short timeframe and without further investment. This is discussed further under *Conditions of expansion* at paragraph 40 below.
- 37.4 Carpet retailers are very sensitive to any price movements, resulting in carpet manufacturers (such as Godfrey Hirst) facing an elastic demand function. Any price increase would lead to retailers switching to a competing domestic player (probably Cavalier at the higher product quality end, and NE at the lower price end), or competing import manufacturer (such as Victoria Carpet Company, discussed further below).
- 37.5 Distribution channels will not be adversely affected by the proposed acquisition. Most retailers have more than one preferred supplier; and some who currently stock both Godfrey Hirst and Feltex brands may seek to add a new second supplier. Given that Cavalier already has its own distributors in most locations, the more likely beneficiary of any dealer switching is NE.
- 38 ***Imports***
- 38.1 The merged entity will continue to be constrained by import competition. **Appendix L** indicates that imports comprised []% of all carpets sold in New Zealand in the 2004/05 financial year. That figure was []% for the previous year, and []% for the year prior to that. There is no tariff on imports from Australia, although carpets imported from elsewhere attract a 15% tariff, which is likely to be steadily reduced over the next three years. A number of retailers import directly themselves, both at the high quality and low cost ends of the market. In addition, an Australian manufacturer of wool and wool-blend carpets, Victoria Carpet Company, distributes in

New Zealand on its own account. There are no barriers, other than tariffs (where applicable), to imports.

- 38.2 The recent OECD Economic Survey on New Zealand recommended that despite prior liberalisation reforms in trade, the functioning of markets could be improved through, among other proposals, “the complete and rapid phase-out of all tariffs and limit subsidies to the Textile, Carpet, Footwear and Apparel sector”.³ This indicates there are likely to be substantive moves at government level to allow further imports of carpet products, whilst removing support to domestic producers.
- 38.3 Each firm accounts for about []% of imports. The balance of imports comprise carpets imported and distributed by a number of importers, and a list of these importers is attached as **Appendix I**.
- 38.4 The Applicant attributes its reduction in overall market share between 2001-02 and 2004-05 (see **Appendix L**) to the greater impact of imported carpets on the New Zealand market, and competition from local manufacturers, such as NE.

39 *Exports*

- 39.1 A further constraint on the combined entity is the ability of competitors to divert export products towards the domestic market, in the event that domestic prices were to rise.
- 39.2 In that regard, the export figures in **Appendix L** show that the volume of carpet exported decreased as a percentage of domestic production between the years 2001-02 and 2004-05. This implies that product can and will be diverted to local supply if market conditions change. At the domestic distribution level, all products go through independent wholesalers and retailers, and none of the manufacturers has their own exclusive distribution arrangements.
- 39.3 While Feltex (and to a much lesser extent, Godfrey Hirst) also export, the merged entity will not have the same incentive to divert exports to the domestic market. Both the parties have presence and distribution in Australia, which the proposed acquisition is designed to utilise. Switching export products to domestic supply would run counter to that driver.

40 **Conditions of expansion by existing competitors**

- 40.1 The Applicant contends that existing competitors in the market are capable of increasing their production within a short timeframe and without further investment.

³ OECD Economic Surveys – New Zealand (July 2005), pp.71-73.

40.2 Both Cavalier and NE would be able to increase their productive capacity. Both companies could achieve this through an increase in shift work without any additional capital investment. The Applicant believes that Cavalier currently operate its plant [

]%. GHA

understands that NE's current operation runs [].

40.3 In addition, both Cavalier and NE could expand their current plants. The purchase and installation of any additional tufting machinery would take up to six months to acquire and install. Both already have access to skilled staff; yarn supplies; brand recognition; and distribution and sales networks. Such a response by those competitors could occur well within the specified one-year time frame in the Commission's *Guidelines*.

41 ***Coordinated market power***

41.1 As with the market for wool scouring services, there is minimal scope for collusion in the market for supply of carpet. Again referring to the Commission's *Guidelines*:

- (a) there is a high degree of competition between existing participants (as exemplified by Feltex's current financial position);
- (b) product is slightly differentiated for differing end users;
- (c) new entry can occur quickly;
- (d) there are a number of fringe players in the industry;
- (e) neither of the parties are maverick players in this industry;
- (f) alternative sales channels ensures that demand is elastic;
- (g) there is no history of collusion in the industry; and
- (h) retailers are well informed about the price schedules and readily switch suppliers in response to uncompetitive pricing.

Constraints on market power by potential competition

42 ***Conditions of entry***

42.1 The rigorous competition provided by Cavalier, NE and imported carpets will be sufficient to constrain the merged entity post-acquisition. The Applicant cannot specifically identify any new entrant likely to enter within the Commission's two year timeframe. While there are no prohibitive barriers to entry (except for necessary capital expenditure and the hiring of skilled staff), the current depressed demand and threat of increased import competition would seem likely to deter any would-be entrant, at least in the

short term. However, the lack of barriers to entry suggests that there is no reason why a new entry could not enter in the medium term (and not bear the same legacy costs as Feltex).

Other potential constraints

43 *Constraints on market power by conduct of acquirers*

43.1 Any unjustified price increase by domestic producers would result in major retailers retaliating by sourcing more imported carpets. All major carpet retailers have an established relationship with at least one overseas manufacturer, and could quickly source additional imports if the domestic entity sought to impose a SSNIP.

43.2 In addition, other intermediaries such as Architects, Interior Designers and Quantity Surveyors are knowledgeable purchasers who would switch custom in the event of an unjustified price increase. The presence of two alternative national suppliers of wholesale carpets, post-acquisition, will provide acquirers with significant countervailing power and will continue to constrain the merged entity. The merged entity will not be in a position of market power to raise prices nor detrimentally affect competition.

Conclusion on supply of carpet

44 The Acquisition, in whatever form, will not lead to a lessening of competition in the market for supply of carpet in New Zealand. Although two established players would merge (one of which is floundering) the remaining presence of:

44.1 two significant national players (each with the ability to expand production quickly);

44.2 active and largely unrestricted imports; and

44.3 knowledgeable and price-sensitive acquirers –

will constrain the merged entity in the factual, leading to the conclusion that competition will not be substantially lessened in the carpet market.

This Notice is given by Tania Pauling, General Manager of Godfrey Hirst NZ Limited.

I hereby confirm that:

- All information specified by the Commission has been supplied;
- All information known to Godfrey Hirst which is relevant to the consideration and determination of this application has been supplied; and
- All information supplied is correct as at the date of this application.

I undertake to immediately advise the Commission of any material change in circumstances to the application.

Dated this 1st day of August 2006

Tania Pauling

I am the General Manager of Godfrey Hirst NZ Limited and am duly authorised to make this application.

APPENDIX A – LETTER AGREEMENT

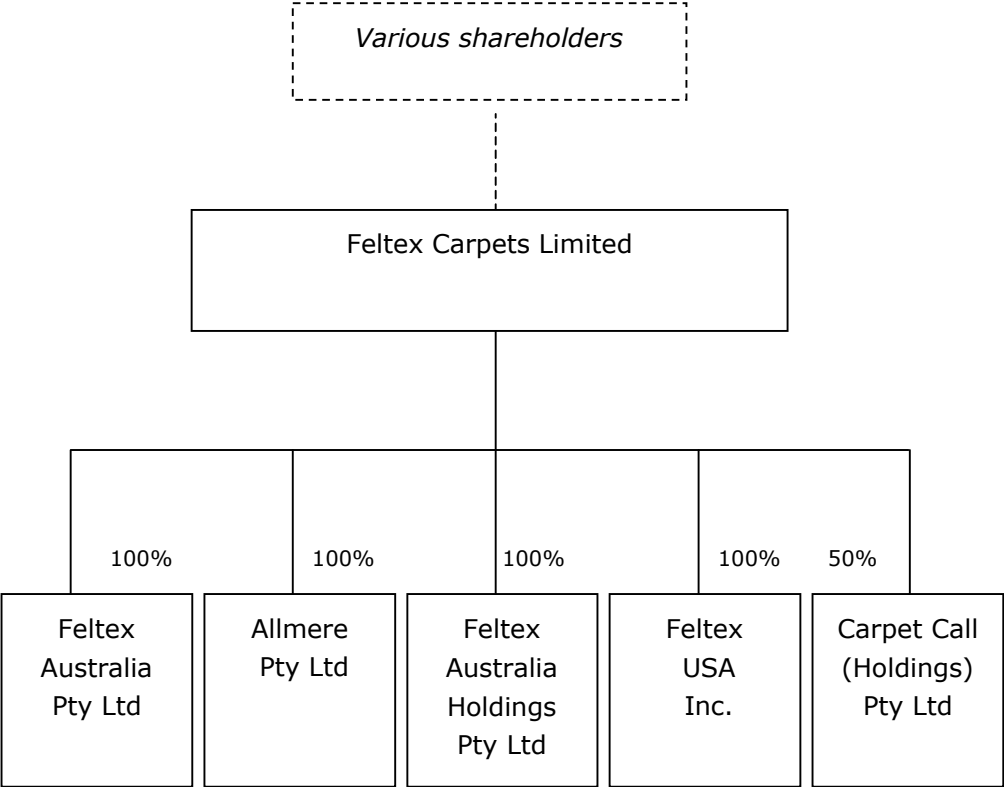
[]

APPENDIX B – FELTEX TOP 20 SHAREHOLDERS
As at 14 July 2006

Holder	Holding	Percentage of total holdings
First NZ Capital Custodians Ltd	4,903,769	3.28
Allan James Hubbard & Margaret Jane Hubbard	3,958,980	2.65
Forbar Custodians Limited	3,329,325	2.23
First NZ Capital Custodians Ltd	3,247,716	2.17
Hemal Lal Patel	2,800,000	1.87
National Nominees New Zealand Limited – A/C NZCSD	2,165,592	1.45
Custody and Investment Nominees Limited – A/C NZC	1,792,091	1.2
Hendry Nominees Limited	1,777,426	1.19
Paul David McGowan	1,552,860	1.04
Philip Robert Briggs & Pamela Annette Briggs	1,073,716	0.72
Richard Whittaker	1,046,980	0.7
Lane Andrew Clayton Hocking	1,000,000	0.67
Market Force Ltd	802,567	0.54
Toocooya Nominees Ltd	764,706	0.51
Doyle Securities Ltd	750,000	0.5
Jarden Custodians Ltd	700,000	0.47
ASB Nominees Ltd	600,000	0.4
Sterling Nominees Ltd	570,000	0.38
Robert William Noe	550,830	0.37
Sok Eng Boey & Yeow Ann Chiam & Kay Hong Chiam	533,000	0.36

Source: Investment Research Group Limited

APPENDIX C: FELTEX CORPORATE STRUCTURE DIAGRAM



APPENDIX D: FELTEX CORPORATE STRUCTURE

- 1 Feltex has the following wholly owned subsidiaries outside New Zealand:

Subsidiary	Principal Activity
Feltex Australia Pty Limited #	Manufacturer and distributor of carpet and yarn
Allmere Pty Limited ^	Investment in associate
Feltex Australia Holdings Pty Limited	Investment holding company
Feltex USA Incorporated*	Yarn distributor

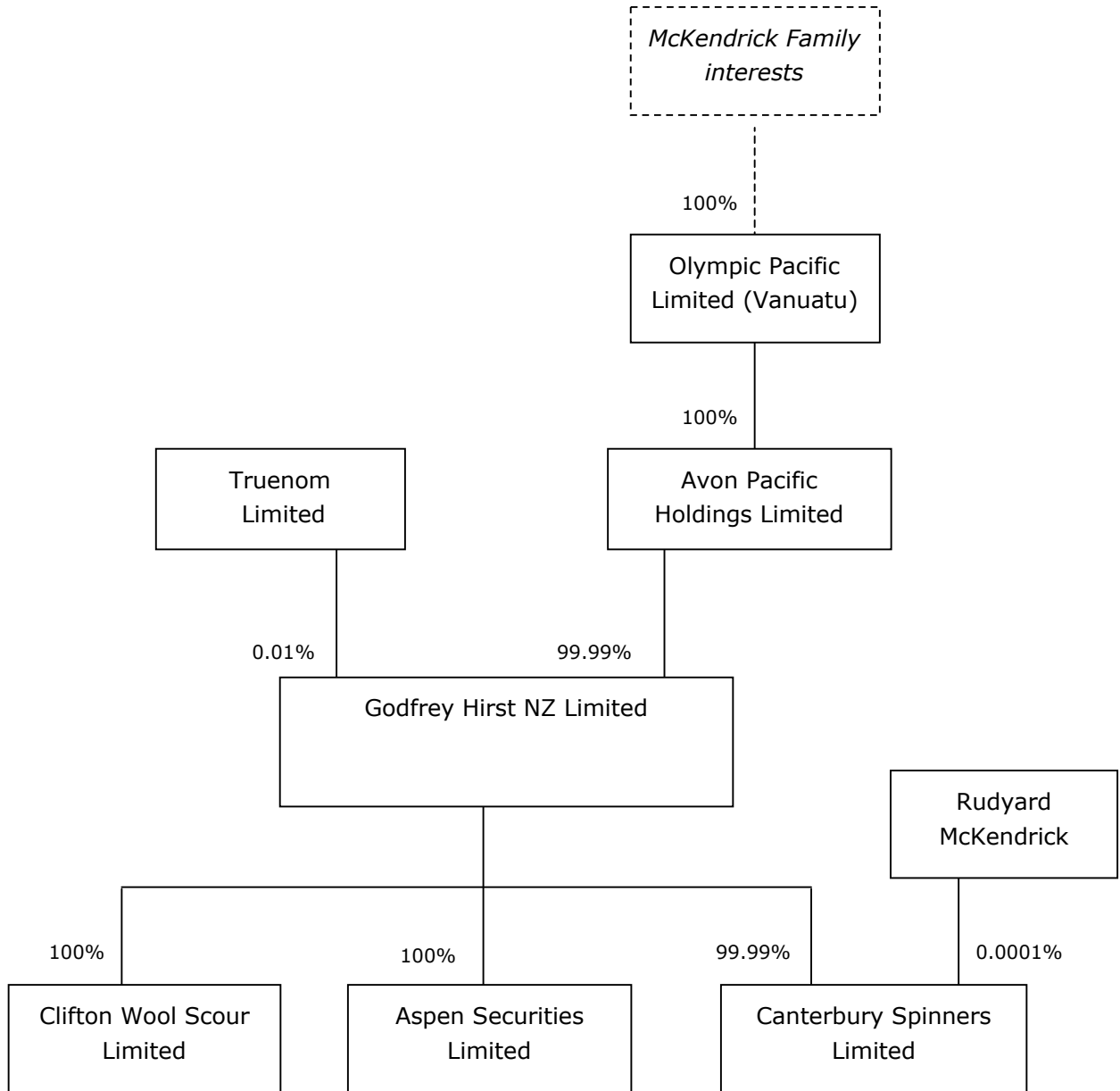
* = directly controlled by Feltex Carpets Limited

= directly controlled by Feltex Australia Holdings Pty Ltd

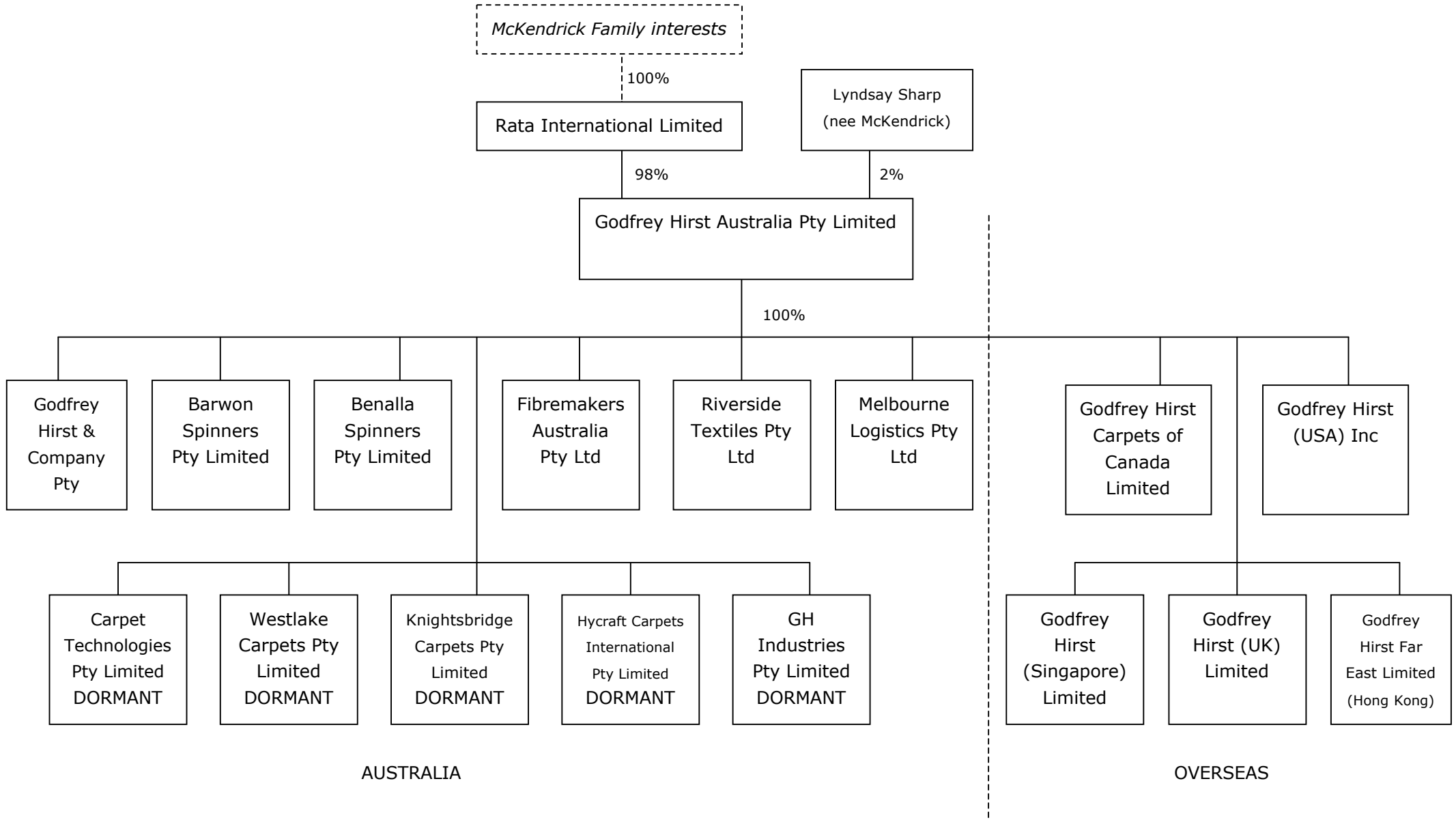
^ = directly controlled by Feltex Australia Pty Ltd

- 2 Feltex also owns 50% of Carpet Call (Holdings) Pty Limited, a company specialising in the wholesale, retail and installation of floor coverings in Australia.

APPENDIX E: CORPORATE STRUCTURE DIAGRAM OF THE APPLICANT



APPENDIX F- GHA GROUP CORPORATE STRUCTURE DIAGRAM



APPENDIX G - GODFREY HIRST AND GHA SUBSIDIARIES

New Zealand

- 1 The Godfrey Hirst Group (New Zealand) comprises the following entities:

Company	Location	Principal Activity	Number of Employees
GHNZ	Auckland	Head Office, tufted carpet production	80
CWS	Invercargill	Wool scouring, wool dumping and greasy blending	70
	Napier	Wool scouring, dumping, blending, dag crushing and fertiliser manufacture	70
	Christchurch	Wool dumping and blending	5
	Dunedin	Wool dumping and woolpack recycling	5
Canterbury Spinners Limited	Christchurch	Production of carpet yarn	270
Aspen Securities Limited	Auckland	Non-trading	N/a
Total			510

Overseas

2 The GHA Group comprises the following entities and facilities:

Company	Location	Principal Activity	Number of Employees
Godfrey Hirst Australia Pty Ltd	South Geelong, Victoria	GHA Group's head office and tufting, carpet dyeing and finishing facilities	Head office: 120 Carpet/samples: 298
Barwon Spinners Pty Ltd	South Geelong, Victoria	Woollen yarn dyeing and spinning	89
Benalla Spinners Pty Ltd	Benalla, Victoria	Woollen yarn spinning	137
Fibremakers Australia Pty Ltd	Bayswater, Victoria	Synthetic yarn production	62
Riverside Textiles Pty Ltd	North Geelong, Victoria	Texturising of synthetic yarns	60
Melbourne Logistics Pty Ltd	Laverton, Victoria	Carpet warehousing and distribution	25
Sales Offices	Melbourne, Sydney, Brisbane, Adelaide and Perth. A sales representative is also present in Tasmania	Residential and commercial carpet market sales	45
Godfrey Hirst (Singapore) Limited, Godfrey Hirst (UK) Limited, Godfrey Hirst Carpets of Canada Limited, Godfrey Hirst Far East Limited, Godfrey Hirst (USA) Inc	USA, Hong Kong and Singapore	Residential and commercial carpet market sales	17
Carpet Technologies Pty Limited, Westlake Carpets Pty Limited, Knightsbridge Carpets Pty Limited, Hycraft Carpets International Pty Limited, GH Industries Pty Limited		Non-trading	N/a
Total			853

**APPENDIX H - MARKET SHARES FOR WOOL DUMPING AND SCOURING
FOR THE YEAR ENDED 2005**

[]

APPENDIX I – IMPORTERS OF CARPET INTO NEW ZEALAND

- 1 The following companies import carpet into New Zealand. Godfrey Hirst has estimated the percentages of imports

Importer	Type of product	Country or Countries of Origin	Estimated percentage of imports
Irvine International Floors Limited	low end tufted polypropylene and solution dyed plush and cut pile nylon, woven wool	UK, Europe, China, South Africa	[]%
Victoria Carpet Company	wool, wool blend	Australia	[]%
Feltex	wool, nylon, polypropylene, tiles	Australia	[]%
GHNZ	wool, nylon, polypropylene, tiles	Australia	[]%
Others	low end polypropylene, nylon, niche market designer wool blend	Various	[]%

APPENDIX J - MANUFACTURING PROCESS FOR GODFREY HIRST CARPETS

- 1 Godfrey Hirst carpets are manufactured using wool, wool/synthetic blends, or synthetic yarns.
- 2 For woollen and wool/blend yarn production:
 - 2.1 scoured wool is purchased, and is sometimes dyed;
 - 2.2 it is blended with other wool or synthetic fibres to obtain the appropriate mix of fibres;
 - 2.3 the fibres are carded so the fibres are aligned in the desired manner;
 - 2.4 the fibres are spun into yarn.
- 3 As part of the manufacturing process for yarn:
 - 3.1 for woollen yarn, strands may be twisted and treated to obtain the thickness and strength required for the carpet; and
 - 3.2 for synthetic yarns, nylon or polypropylene polymer is heated and drawn through small holes to make long thin fibres. These fibres are then bunched together to make a strand of yarn. The strands are then twisted together and heat set to maintain shape and thickness.
- 4 Godfrey Hirst manufactures only tufted carpets. To manufacture tufted carpet, strands of yarn are individually inserted into a woven or non-woven backing using a needling technique. The backing is coated with a latex compound to anchor the tufts. A secondary backing is used in the finishing process to add strength and stability.
- 5 Godfrey Hirst carpets are produced in various textures including:
 - 5.1 *Loop pile* formed by a continuous row of loops which can have uniform or varying heights;
 - 5.2 *Cut loop pile* where some of the loops are cut while others are left uncut; and
 - 5.3 *Cut pile* where all the loops are cut, producing yarn that stands upright and forms an even surface.

APPENDIX K – MANUFACTURERS, DISTRIBUTORS AND RETAILERS IN THE MARKET FOR SUPPLY OF CARPET

Manufacturers

- 1 GHA estimates that the market shares for the supply of carpet in New Zealand is as follows:

Manufacturer	Products	Estimated market share
Godfrey Hirst	Tufted wool, wool blend and synthetic carpets, tiles	[]%
Feltex	Woven wool carpets, tufted synthetic, wool, and wool blend carpets, tiles	[]%
Cavalier Bremworth	Tufted wool, synthetic, and wool blend carpets, tiles	[]%
Norman Ellison	Tufted wool, wool blend, and synthetic carpets	[]%
Carpet Importers (excluding Godfrey Hirst)	Various	[]%

Distributors and Retailers

- 2 The following distributors and retailers operate in the market for supply of carpet in New Zealand:

Name of Company	Distribution/Retail area	Manufacturers distributed	Estimated percentage of distribution volume
Carpet Court	Nationwide	GHNZ, Cav, Ftx	[]%
Flooring First	Nationwide	NEC, Ftx, Irvines	[]%
Floorpride	South island	GHNZ, Cav, Ftx	[]%
Jacksons	Central North Island	GHNZ, NEC, Ftx	[]%
Others	Nationwide	GHNZ, Ftx, Cav, NEC	[]%

**APPENDIX L – MARKET FOR SUPPLY OF CARPET IN NEW ZEALAND
PRODUCTION, IMPORTS AND EXPORTS OF CARPET**

[]