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Determination

Are Media Limited and Ovato Retail Distribution NZ Limited [2021] NZCC 13

The Commission:	Dr Derek Johnston Dr John Small John Crawford
Summary of application:	An application from Are Media Limited seeking clearance to acquire 100% of the shares in Ovato Retail Distribution NZ Limited.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission gives clearance to the proposed acquisition.
Date of determination:	25 August 2021

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

The proposed acquisition

1. On 19 July 2021, we registered an application (the Application) from Are Media Limited (Are Media) seeking clearance to acquire 100% of the shares in Ovato Retail Distribution NZ Limited (ORD NZ), which is ultimately owned by Ovato Limited (Ovato) (the Proposed Acquisition).

2. The Proposed Acquisition relates to the supply of retail distribution services to magazine publishers. With the Proposed Acquisition, Are Media (a magazine publisher) would become vertically integrated with the only distributor of magazines to retail outlets in New Zealand (ORD NZ).

Our decision

3. The Commission gives clearance to the Proposed Acquisition as it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

4. The Proposed Acquisition is part of a wider transaction that included Are Media also acquiring Ovato's retail distribution business in Australia. Ovato has been in financial difficulties for some time, as a result of declining print volumes and also significant negative effects of the COVID-19 pandemic. Ovato publicly stated that the Proposed Acquisition is required to strengthen its balance sheet, while also providing funds for further cost-saving initiatives.

5. A key focus of our investigation was the assessment of the counterfactual; that is, what would likely happen to ORD NZ if it was not sold to Are Media absent the Proposed Acquisition. After careful consideration, including taking into account the financial position of Ovato, we determined that in the counterfactual:

    5.1 Ovato would likely become insolvent and, as a result, ORD NZ would be likely to cease magazine distribution operations in New Zealand; and

    5.2 it is unlikely that ORD NZ's assets would be acquired by a third party that would use them to distribute print magazines to retailers in New Zealand.

6. As a result of the above, we were satisfied that in the counterfactual, publishers would be left without a distributor of print magazines to retail outlets in New Zealand. In our view, such an outcome would likely inflict significant harm on these publishers, to the point that multiple publishers would likely no longer be viable and be forced to close or cease offering their titles in New Zealand.

7. The Proposed Acquisition would result in Are Media owning the only distributor of print magazines to print retailers, which could give it the ability and incentive to give preferential treatment to its own publications over those of its competitors. However, we were satisfied that this would still be a better outcome for competition than the counterfactual. We were therefore satisfied that the Proposed Acquisition would not amount to a substantial lessening of competition.

Our framework

8. Our approach to analysing the competition effects of mergers is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).[1]

9. We assess mergers using the substantial lessening of competition test. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[2]

10. Where, absent a merger, a target is unlikely to continue operating, and its assets are unlikely to remain in the market under different ownership, the firm can be described as a 'failing firm'.[3] In these circumstances, there is very often no difference in competition between the counterfactual and the factual.[4] However, there are some limited circumstances where the factual and counterfactual will not be the same, such as where a target is the only player active at a particular level of the supply chain.

The parties

Are Media

11. Are Media Limited is the New Zealand subsidiary of the Australian company Are Media Pty Limited (together, 'Are Media'). Are Media publishes a range of well-known magazines for New Zealand audiences, such as *The New Zealand Listener*, *Your Home and Garden*, *Woman's Day*, and *New Zealand Woman's Weekly*.[5] Are Media is not currently involved in the supply of magazine distribution services in New Zealand.[6]

ORD NZ

12. ORD NZ provides retail distribution services to magazine publishers, including Are Media, and is currently the only distributor of magazines to retailers such as supermarkets, services stations and book stores in New Zealand.[7]

13. ORD NZ is owned by Ovato NZ Limited, which is in turn owned by Ovato, an ASX-listed company. In addition to retail distribution services, Ovato provides other services to the print media industry, including printing and residential distribution services to magazine publishers and other customers.

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1 Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019).
2 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].
3 See Mergers and Acquisitions Guidelines above n1 at Attachment E.
4 See Mergers and Acquisitions Guidelines above n1 at Attachment E at [E3].
5 The Application at [41].
6 The Application at [3].
7 The Application at [27.2] and [47].

14. The Proposed Acquisition is part of a wider transaction that included Are Media also acquiring Ovato's retail distribution business in Australia. Ovato has been in financial difficulties for some time, as a result of declining print volumes and also significant negative effects of the COVID-19 pandemic. The Proposed Acquisition is required to strengthen Ovato's balance sheet and avoid it becoming insolvent, while also providing funds for further cost-saving initiatives. In New Zealand, the Proposed Acquisition relates only to the sale and purchase of ORD NZ, and Ovato would retain its printing and residential distribution services post-acquisition.[8]

Market definition

15. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act 1986, as a matter of fact and commercial common sense.[9]

16. Are Media submitted that it was unnecessary to identify or rely on any particular market definition(s) for the purposes of assessing the Proposed Acquisition, but identified three potential markets:[10]

    16.1 the national market for distribution of print magazines;

    16.2 the national market for supply of media content to consumers; and

    16.3 the national market for supply of advertising services.

17. In reaching a decision on the Proposed Acquisition we did not need to identify the precise boundaries of the relevant markets. The relevant markets include markets for the distribution of print magazines and for sale of print magazines. There are a wide range of magazine categories, which consistent with a previous decision of the Commission likely fall in different markets,[11] but we were able to reach a decision in this case simply by considering the impact of the Proposed Acquisition on magazine publishers generally.

With and without scenarios

18. With the Proposed Acquisition, Are Media is acquiring ORD NZ.

19. In the counterfactual, we consider that the only likely scenario would be ORD NZ ceasing to operate as a going concern and its assets exiting the relevant market(s) in New Zealand. This is because, based on the evidence we received, in our view:

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8 The Application at [2] and Ovato ASX announcement (31 August 2021).

9 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

10 The Application at [98]-[99].

11 Bauer Media Group NZ LP and APN Specialist Publications NZ Limited]2014] NZCC 1.

19.1 in the counterfactual, Ovato would be likely to fail and, as a result, ORD NZ would be likely to cease operating and exit the relevant market(s) in New Zealand; and

19.2 it is unlikely that ORD NZ's assets would be acquired by a third party that would use them to distribute print magazines to retailers in New Zealand.

20. We discuss each of the above further below.

Ovato is likely to fail and cease operations

21. We consider that, in the counterfactual, Ovato would be likely to fail (that is, become insolvent and be put into liquidation) and, with the failure of Ovato, ORD NZ would be likely to cease operating and exit the relevant market(s) in New Zealand.

The Parties' and Ovato's submissions

22. Relevant to our assessment of whether Ovato is likely to fail and cease operations, Are Media and ORD NZ (the Parties) submitted that:

22.1 the ongoing decline in the print industry (and Ovato's revenues), along with Ovato's high fixed costs and impacts of the COVID-19 pandemic, had resulted in Ovato experiencing serious financial difficulties;[12]

22.2 in 2020, Ovato undertook capital raising, refinancing and restructuring in efforts to restructure its balance sheet and address its financial position;[13]

22.3 the efforts undertaken in 2020 had not stabilised Ovato's business and its financial position was, at the time this clearance was assessed, very precarious;[14]

22.4 Ovato needed to sell non-core assets, including ORD NZ, to ensure that its print business remained viable;[15]

22.5 if the Proposed Acquisition [ ];[16] and

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12 The Application at [24], [80] and [83].

13 The Application at [83]-[84]. Refinancing included the securing of a new debt facility, creditors agreeing to a write down in the money they were owed and bond holders agreeing to have their debt converted to equity. Restructuring included the closure of its Clayton printing facility, rationalisation of workforce and the liquidation of some group companies.

14 The Application at [80] and [85]. Ovato separately advised that its efforts in 2020 were not sufficient to arrest Ovato's financial difficulties and materially improve its financial circumstances. Revenue levels had not returned in 2021 to the levels that had been forecast in 2020 [ ]. Letter from Ovato to the Commerce Commission (8 July 2021) and letter from Ashurst (on behalf of Ovato) to the Commerce Commission (23 July 2021).

15 The Application at [86].

16 The Application at [81].

22.6 the likely counterfactual involved [ ].[17]

23. Ovato separately submitted that [ ]. Ovato advised that the Proposed Acquisition was essential for it to benefit from [ ]:[18]

23.1 [ ]; and

23.2 fund redundancies and restructuring needed to further reduce Ovato's cost base and better align it with its declining revenues.

24. Ovato further submitted that it would be [ ].[19]

25. Ovato submitted that [ ].[20]

Evidence and analysis

26. Evidence from the material that Ovato has publicly released to the ASX, along with internal Ovato documents, confirms that it had had a trend of negative cashflows or cashflow issues since around 2017. The publicly available financial records of Ovato also record the substantial decline that it has seen in its revenues and the decline in its financial position (particularly in terms of its working capital and liquidity). They also record that Ovato's financial position significantly worsened in 2020.[21]

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17 The Application at [36].

18 Letter from Ovato to the Commerce Commission (8 July 2021), letter from Ashurst (on behalf of Ovato) to the Commerce Commission (23 July 2021) and letter from Ashurst (on behalf of Ovato) to the Commerce Commission (19 August 2021).

19 Letter from Ashurst (on behalf of Ovato) to the Commerce Commission (19 August 2021).

20 Letter from Ovato to the Commerce Commission (8 July 2021). Ovato advised that [ ]. Letter from Ashurst (on behalf of Ovato) to the Commerce Commission (23 July 2021).

21 In the second half of calendar year 2020, Ovato started having to provide quarterly cashflow, funding and solvency updates to the ASX. It also received a qualified report from its external auditors noting material uncertainty in terms of the going concern position of Ovato. At its 2020 AGM, Ovato chairman described

27. As noted above, Ovato undertook significant restructuring and refinancing in 2020 in efforts to rescue the business. These initiatives aimed to restore Ovato's balance sheet and, in the future, its profitability. Documents released to the ASX as part of these efforts included external advice forecasting that, absent these initiatives, Ovato would likely have been insolvent by January 2021.[22] Some of the restructuring undertaken by Ovato in 2020 was done via a scheme of arrangement. We note that in approving this restructuring, the NSW Supreme Court accepted Ovato's evidence that "the relevant Ovato Group companies would at least have been placed in administration, and potentially in liquidation, absent the restructuring".[23]

28. While these 2020 initiatives referred to above significantly reduced Ovato's debt levels, for several reasons (including the ongoing impacts of the COVID-19 pandemic) they did not materially improve Ovato's overall financial circumstances. Ovato's first quarterly cashflow update released in 2021 estimated that, at that time, it only had enough funds to cover one more quarter of operating cashflows and, as such, was looking at options to raise further cash.[24] This led to Ovato announcing in June 2021 the Proposed Acquisition along with the sale of its retail distribution and marketing services businesses in Australia. In announcing these business unit sales, Ovato noted that the sales would provide it with cash for the ongoing transformation of Ovato, be a catalyst for corporate cost reductions and allow Ovato to focus on its core printing business.[25]

29. Ovato's internal documents provide further evidence of its cashflow and liquidity issues, and the considerable efforts of its management, Board and external advisors (over a number of years, but the last 18 months in particular) to restructure, refinance and rescue the business. [ ][26] Internal documents show that at the same time as Ovato had engaged in initiatives to rescue and transform the business**,** it had also planned for the possibility of Ovato going into administration.[27] Ovato had been doing [ ] forecasts and monitoring of cashflows. [ ] to cover the "immediate liquidity needs to keep the business operational" and also to

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its 2020 financial year as a year like no other which had put considerable pressure on Ovato's liquidity. Shareholders were told that Ovato need to restructure in order "to survive, stabilise and continue".

22 McGrath Nicol report attached to restructure and recapitalisation materials released to the ASX by Ovato (19 November 2020).

23 In the matter of *Ovato Print Pty Ltd [2020] NSWSC 1882* (21 December 2020) at [51].

24 Ovato market update and cashflow report for the quarter ended 31 March 2021 (30 April 2021).

25 Ovato ASX announcement (4 June 2021). In papers subsequently circulated to shareholders to vote on the sale of ORD NZ and Ovato's Australian retail distribution business, the Board of Directors stated that the sale would ensure Ovato is able to continue to operate as a going concern. Notice of extraordinary general meeting (15 June 2021).

26 For example, see [ ]

27 For example, see [ ].

"manage liquidity pending the sale" of ORD NZ.[28]

30. Ovato has plans to undertake further restructuring of its business with a view to returning the business to profitability and a stable financial position. After reviewing Ovato's cashflow forecasts and analysis,[29] alongside Ovato's internal documents, we are satisfied that the Proposed Acquisition is necessary to fund this restructuring. In the counterfactual, we consider it unlikely that Ovato would be able to refinance the business to fund this restructure within the timeframe required and before the failure of Ovato.

31. Given the above, we consider that, in the counterfactual, Ovato would be likely to fail (become insolvent, be put into administration and cease operations) and would likely do so within a very short timeframe.

32. [ ].[30] [ ].[31]

The assets would not be used for the retail distribution of print magazines

33. We consider that, in the counterfactual, the assets of ORD NZ are not likely to be used by a third party for the retail distribution of print magazines.

34. Ovato submitted that it is very unlikely that[ ] it [ ] could find an alternative purchaser for ORD NZ, let alone a purchaser that would provide sufficient funding [ ]. Ovato has explored potential sales of parts of its business before, [ ] but has identified no interested buyers. Ovato had not contemplated sale of ORD NZ prior to April 2021 and has not had an opportunity to test the market to see if there might be other buyers for ORD NZ. However, Ovato considers it is a forced seller and does not consider ORD NZ to be an attractive standalone business to alternative purchasers. Ovato also considers it unlikely that an administrator could identify an alternative purchaser for ORD NZ].[32]

35. We consider it unlikely, in the counterfactual, that Ovato could find an alternative purchaser for ORD NZ and complete any sale to such a purchaser before Ovato

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28 [ ]

29 [ ]

30 [ ]

31 [ ]

32 Letter from Ovato to the Commerce Commission (8 July 2021), letter from Ashurst (on behalf of Ovato) to the Commerce Commission (23 July 2021) and letter from Ashurst (on behalf of Ovato) to the Commerce Commission (19 August 2021).

would become insolvent and fail. There has been significant information publicly available relating to Ovato's financial profitability and position for several years and no buyer for ORD NZ has approached Ovato.

36. If Ovato failed and went into administration in the counterfactual, we consider it would be unlikely that the assets of ORD NZ would be acquired by a party that would use them to distribute magazines to retailers. This is because:

    36.1 ORD NZ is not a particularly capital-intensive business and does not have many saleable assets. ORD NZ has few physical assets (beyond its software and the algorithm and related data) that could be acquired by an entrant seeking to distribute magazines to retailers. It is unlikely that any of the business's customer contracts could be sold or assigned to a buyer of ORD NZ's assets.[33]

    36.2 It would take time for a receiver to undertake a sales process to sell Ovato's assets and the value of ORD NZ would decline quickly once Ovato had failed. Once Ovato had been put into administration, any receiver is likely to close it down quickly because it would not have assets on which to continue to trade.[34] If ORD NZ ceased operations, its publisher customers would need to secure alternate ways to get their magazines to market and some may get into financial difficulties and fail. This would reduce the value, and attractiveness, of ORD NZ's assets, further reducing the likelihood of a sale.

Potential vertical concerns

37. With the Proposed Acquisition, Are Media (a magazine publisher) would own the only retail magazine distributor in New Zealand (ORD NZ). In the counterfactual, it is unlikely that ORD NZ's assets would continue to be used to supply retail distribution services in New Zealand to magazine publishers.

38. We considered whether the Proposed Acquisition could give rise to potential vertical concerns when compared with the likely counterfactual.

39. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical effects. This can occur where a merger gives the merged entity a greater ability or

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33 Ovato told us that [ ]. Commerce Commission interview with Ovato (10 August 2021). Even if Ovato's contracts with publishers and retailers did not terminate upon the failure of Ovato, publishers and retailers would likely be owed money by Ovato. In our view, this would materially impact on any attempt to have such contracts assigned to a buyer and make it unlikely that it would be feasible to sell these contracts along with other assets of ORD NZ. These issues with the assignment of customer contracts would similarly apply the assignment of any leases for the premises from which Ovato operates. Although in the case of any site lease, we note that Ovato's landlord may also prefer to rent the warehouse space used by ORD NZ to another party for an alternative use, if this were to be more profitable for it.

34 Ovato has already sold its receivables to Scottish Pacific as part of its receivables financing facilities.

incentive to engage in conduct that prevents or hinders rivals from competing effectively (which we refer to as 'foreclosing rivals').

40. Overall, we consider that the effects of any plausible theory of harm connected with the Proposed Acquisition are likely to be less severe for competition between magazine publishers than the effects of ORD NZ's assets disappearing entirely from the relevant market(s).

41. The focus for our vertical assessment was whether the merged entity would have the ability and incentive to restrict rival publishers' access to distribution services. We consider that this foreclosure theory of harm was the only plausible one raised by the Proposed Acquisition.

42. In our view, even if the merged entity did have the ability and incentive to foreclose some rival publishers it would be unlikely to have many opportunities to engage in foreclosure. We consider that general foreclosure of all rival publishers is unlikely to occur due to title differentiation and also because foreclosure of all rival publishers would mean that the merged entity would be unable to cover the high fixed costs of operating ORD NZ's business.[35]

43. By contrast, since all publishers of print magazines rely on ORD NZ for retail distribution in New Zealand, publishers would be left without a retail distributor in the counterfactual. Without a distributor, we consider it highly likely that this would result in some publishers failing (or, in the case of international publishers, withdrawing from New Zealand).[36] We further consider that those that survive are likely to face short term harm while they seek alternative distribution arrangements, and may face increased distribution costs in the medium to long term if alternate distribution channels are not as efficient as ORD NZ. We consider that such an outcome would be worse for competition between magazine publishers, and ultimately for consumers – who may lose access to titles that they value – than the effects of any partial foreclosure strategy

Overall conclusion

44. In the counterfactual, ORD NZ would exit the market, leaving publishers without a distributor of print magazines to retailers. While it is possible that the Proposed Acquisition could give Are Media the ability and incentive to foreclose certain publishers, even if this is the case, we consider that this would be a better outcome for competition than the situation in the counterfactual.

45. Accordingly, we are satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market.

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[35] ORD NZ's has high fixed costs and its profitability is very sensitive to reductions in volume and revenue. ORD NZ is heavily dependent on the business of magazine publishers other than Are Media to continue to be financially viable. The Application at [124] and [127].

[36] Some magazine publishers highlighted this risk in interviews with the Commission.

Determination on notice of clearance

46. Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Are Media Limited to acquire 100% of the shares in Ovato Retail Distribution NZ Limited.

Dated this 25th day of August 2021

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Dr Derek Johnston
Division Chair