Our Position on the Proposed Merger

Entry has little potential to constrain monopoly pricing by the merged entity. This is because:

- The merger is designed to reduce spare capacity in the industry, and the merger proposal now indicates that optimal capacity is one large scouring plant in each of the North Island and South Island.
- Since the North Island and South Island are differentiated markets, constraint of pricing through entry requires an entrant to commit to two plants, on in each island. This means that entry will take capacity from two plants to four, which seems unlikely to be sustainable given that the rationale for the merger involves the claim that it would be inefficient to have two plants.
- Lempriere's entry to the market provides evidence for the claim that entry based on two firms and four or more plants is unsustainable. Having entered the New Zealand market through the acquisition of WSI, Lempriere now seeks to merge NZWS and CWH on the claim that removal of spare capacity will benefit consumers. We must presume that other potential entrants will have noticed Lempriere's experience and factor that into their decision. In other words, whatever likelihood there was of a potential entrant making the required investment pre-Lempriere, the likelihood would be lower now even if all the other circumstances had not changed.
- In these circumstances, the expected return (hurdle rate) required by any potential entrant would be high, and in fact too high to make it likely that entry would constrain a SSNIP by the monopoly wool scourer.

The scouring of coarse wool in China has little potential to constrain monopoly pricing by the merged entity because:

- The costs of transport to China and back to New Zealand are very high, especially when the transport costs include the cost of the capital invested in the wool while it is being transported and in storage.
- The ability for Chinese scours to scour coarse New Zealand wool to the appropriate standards and on the "just in time" basis that Godfrey Hirst currently obtains clean wool in New Zealand is in doubt.

Our position on ownership structure and the options for Lempriere to increase its shareholding is as follows:

- We have reviewed the Commission's file note of 22 January 2015, and note that the option for Lempriere to increase its holding from 45% to 72.5% by acquiring the shares of ACC and DC is at $14 per share compared to a transaction price of $[ ]per share (a near [ ]% premium).
- We do not consider premium associated with these options to be unusually high in the context of the international evidence for transactions in which control is acquired. For example, Bretton et al. (2009, Table 1) report that, on average, the final offer price in a takeover in the US during the period 1973-2002 was 46% higher than the target's share price before the takeover bid was launched. Alexandridis et al. (2013) report that takeover premia in the US during 1990-2007 were larger for smaller targets: for the third of their sample

made up of the smallest target firms, the offer price was 54% higher, on average, than the target's share price before the merger announcement.

- We note that the floor price for the option increases by 15% per annum. In our view this increase should be interpreted as a penalty for failure to exercise the option immediately. In other words, the annual increase in the floor price of the option should be regarded as incentivising Lempriere to exercise the option at the earliest possible time.
- Overall, we believe that it is likely that the option is designed to be exercised quickly, and that it is likely that Lempriere will hold 72.5 percent of CWH soon after the merger is executed.

Our position on the economics of the merger analysis given the above is that any benefits from the merger may not be retained in New Zealand, and the detriments from the merger are likely to be larger than have been calculated by NERA and by the Commission in Decision 725. The reasons are that:

- Foreign control of Lempriere is a major departure from the benefit/detriment analysis undertaken by the Commission in Decision 725 and by the High Court. With Lempriere being controlled by investors in Asia, there can be no guarantee that a high proportion of the benefits from the merger will be retained in New Zealand.
- With Lempriere having the ability to acquire control of CWH, the merged entity has the potential to be controlled by an owner that has no stake in manufacturing processes that use clean wool in New Zealand. This increases the potential for the merged entity to be stripped of assets or rationalised internationally, with consequent leakage of benefits from the merger outside New Zealand.
- With very limited potential for pricing by a monopoly wool scour to be constrained by potential entry or wool scours in China, the detriments are likely to be larger than calculated by NERA.

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