PUBLIC VERSION

COMMERCE ACT 1986 : BUSINESS ACQUISITION
SECTION 66: NOTICE SEEKING CLEARANCE

The Registrar
Business Acquisitions and Authorisations
Commerce Commission
P O Box 2351
WELLINGTON

Date: 27 October 2004

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

EXECUTIVE SUMMARY

Proposed Acquisition

The Notice concerns the proposed acquisition by the applicant of the structural and wood processing business and assets of Tenon Limited and/or its wholly owned subsidiaries which is based on and includes:

(a) Kawerau Sawmill and Remanufacturing Plant;

(b) Rainbow Mountain Sawmill;

(c) Ramsey Roundwood; and

(d) Mount Maunganui Plywood.

The application analyses the effects of the proposed acquisition on the following markets:

(a) The production and supply of sawn timber in the North Island.

(b) The production and supply of plywood into various end-uses (viewed either as markets or components of a construction materials market, nationally) such as:

  (i) flooring construction;

  (ii) building cladding;

  (iii) structural uses in construction;

  (iv) packaging.

(c) The production and supply of roundwood products in the North Island.

We summarise the expected impact of the proposed acquisition on the markets as follows.

Sawn timber

The proposed acquisition of the two sawmills is within the Commission's safe harbours. There are a large number of competitors (approximately 200 sawmills in the North Island), and export diversion continues to provide significant constraint. The factors which supported the Commission's conclusions in Decisions 426 and 467 still prevail, but more so. In particular, increasing volumes of wood and the dis-integration of forest ownership from processors is increasing the availability of "free'" volumes of wood available and processing capacity among all market participants is also increasing, with large scale sawmill developments announced by

Ernslaw One, TDC and the applicant. Anti-competitive effects are unlikely as a result of an acquisition.

Plywood

Plywood is not a separate product market. Plywood products are supplied into a large number of end-uses, where they compete with a great range of substitutes. Examples include flooring (which the Commission has examined previously in Decision 213), where particle board and concrete have the most significant shares, and architectural cladding (considered in Decision 412), where numerous products compete and plywood products, enjoy a very modest share. Given the large number of disparate end-uses, generally all related to the construction industry, there are good grounds for the market to be defined as that for construction materials. This is supported by comments of the Commission to similar effect in Decision 431 (*Nelson Pine Industries/Rayonier*). However, the applicant has also taken cognisance of the Commission's approach in Decision 213 (*Fletcher Challenge/NZ Forest Products*), where the Commission adopted a submission that the wood-based panels industry should be viewed in the context of the associated end-use markets. In effect, the various end-uses are the components of the broader market and ultimately, the same competitive conclusions will result.

While expansion possibilities exist for local processors, and imports of plywood are significant and growing (presently representing [ ] of overall volume sold in New Zealand, and likely to follow the Australian experience where imports represent [ ] of the market), the fact is that there are so many substitutes for plywood in all applications that the proposal will not substantially lessen competition, whether viewed in the aggregate as a construction materials market or with respect to the individual segments of such a market relating to the particular end-uses of the products.

Roundwood

The applicant currently has a share of the North Island roundwood market that is less than [ ]. The proposed acquisition falls within the Commission's safe harbours. In addition, roundwood production is relatively unsophisticated and barriers to expansion or entry are low, there are a large number of competitors, and the availability of log supply, which is already extensive, is increasing with a number of firms divesting their forestry assets, including the applicant as recently announced. The proposed acquisition will not substantially lessen competition in the market for roundwood products in the North Island.

Wood fibre flows

The proposal will have no negative impacts on wood fibre flows, and will be neutral at worst. There is no shortage of logs, which trend is likely to increase, and ongoing elimination of vertical integration through the sale of forests by processors (including the applicant's recent announcement as to approximately one third of its forest estate) enhance access to wood fibre by "independent" processors.

PART I: TRANSACTION DETAILS

1. THE BUSINESS ACQUISITION FOR WHICH CLEARANCE IS SOUGHT

1.1 The acquisition by Carter Holt Harvey Limited or a wholly owned subsidiary ("**CHH**") of the structural wood processing business and assets of Tenon Limited and/or its wholly owned subsidiaries ("**Tenon**") which is based on and includes the following:

(a) Kawerau Sawmill and Remanufacturing Plant.

(b) Rainbow Mountain Sawmill.

(c) Ramsey Roundwood.

(d) Mt Maunganui Plywood.

2. The person giving notice

2.1 This notice is given by:

Nic Short
General Counsel
Carter Holt Harvey Limited
640 Great South Road
Manukau City
Auckland

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

Matthew Dunning
Barrister
Park Chambers
Level 4, Victoria House
23 Victoria Street East
Auckland

Telephone: (09) 379 9780
Facsimile: (09) 377 0361
Email: mdunning@parkchambers.co.nz

3. Confidentiality

3.1 Confidentiality is not sought for the fact of this application.

3.2 Confidentiality is sought for the information identified by, and contained within, square brackets.

3.3 The grounds upon which confidentiality is sought are that the information is of a commercially sensitive strategic nature, including market share figures, market research, and market sensitive strategic information relating to the applicant's business, all of which is confidential to the applicant or the target.

4. Details of the participants

Acquirer

4.1 CHH (contacts as above).

Target

4.2 Tenon.

In the first instance, contact:

Haydn Wong
Bell Gully
Barristers and Solicitors
Level 21, Vero Centre
48 Shortland Street
Auckland

Telephone: (09) 916 8000
Facsimile: (09) 916 8801

5. Interconnected or associated persons

Acquirer group/associates

5.1 CHH is a public company incorporated in New Zealand and listed on the Australian and New Zealand stock exchanges. A copy of the latest annual report is at http://www.chh.com.

5.2 CHH is 51% owned by International Paper Company. International Paper Company is incorporated in New York and its shares are traded on the New York, Swiss and Amsterdam stock exchanges. A copy of its latest annual report is available at http://www.internationalpaper.com.

Target company/group associates

5.3 Tenon and its subsidiaries are directly or indirectly majority owned by Rubicon Limited ("**Rubicon**"), which is a public company listed on the New Zealand stock exchange. Tenon is also publicly listed on the New Zealand stock exchange, and has recently delisted from the Australian and New York stock exchanges. A copy of Tenon's latest annual report is available at http://www.tenon.com. A copy of Rubicon's latest annual report is available at http://www.rubicon.co.nz.

6. Beneficial cross-entitlements

6.1 [ ]. Apart from routine commercial supply relationships (eg Placemakers) and industry fora, there are no links between participants and their competitors.

7. Links between participants, and between participants and their competitors

7.1 There are none.

8. Cross-directorships between acquirer and any other market participant

8.1 There are none.

9. The business activities of the participants

9.1 Tenon operates a number of wood processing and sawmill facilities located in the central North Island of New Zealand and produces wood products for the Australian, American, Asian, European and New Zealand markets.

9.2 CHH is a wood fibre products company and carries on business activities in forests, wood products, pulp and paper, packaging and building supplies. It produces wood products for the same markets.

10. Reasons for the proposal

10.1 The acquisition provides CHH with the opportunity to achieve greater economies of scale and extract cost synergies to lower CHH's overall marginal processing costs. Improving CHH's cost competitiveness is imperative to ensure the continued value added domestic processing of New Zealand fibre (rather than the export of unprocessed logs), in a competitive industry faced with reducing margins. The benefits of the cost savings will enable CHH to move towards a level of cost competitiveness in line with benchmarked international wood processors, which will ultimately result in lower domestic lumber prices for New Zealand consumers and increased export sales of value added products.

PART II: IDENTIFICATION OF MARKETS AFFECTED

11. Horizontal aggregation

Market Definition

11.1 The Commission has had opportunity on a number of occasions in the past to consider businesses and markets relating to the production and processing of wood fibre in New Zealand. The forestry industry is projected to grow significantly in the coming years when harvesting of the considerable planting undertaken through the early 1980's and 1990's steps up. This application relates to the processing level only, insofar as it involves the acquisition of two structural grade saw mills (including a remanufacturing plant at Kawerau), a roundwood mill and a plywood mill.

11.2 The Commission has previously defined a market for the production and supply of sawn timber in the North Island (Decisions 426 and 468). It was observed that there may be argument for a national market but it was not then necessary to come to any such conclusion. A greater volume of sawn timber moving between the two islands since those decisions has increased support for the argument but, again, it is unnecessary for the purposes of this application to broaden the market definition accordingly. Equally, there is no reason to depart from the Commission's previous analysis in terms of "sawn timber" and define separate product markets by reference to appearance, structural or industrial grades. The same reasoning which has been applied by the Commission before to support a "sawn timber" product definition continues to apply.

11.3 The plywood mill manufactures and supplies plywood of various specifications for different end uses, nationally. There is no such thing, as a matter of fact and commercial common sense, as a plywood product market per se. The circumstances in

Decision No. 431 (*Nelson Pine Industries/Rayonier*) which led the Commission to define a narrow market, by reference in that case to the manufacture and supply of medium density fibreboard ("**MDF**"), do not occur here (principally, there the applicant advanced a narrow market definition and also, in general, the substitution observed with particle board and plywood "tends to be one way. In other words, while MDF can be substituted for particle board or plywood in almost all applications, the reverse is not the case": paragraph 35).

11.4 Plywood, on the other hand, competes with a range of products which can be substituted for it, in applications such as:

(a) architectural claddings, primarily residential (in competition with other cladding such as weatherboard, plaster, monolithic claddings including polystyrene based laminated panels as considered in Decision No. 412 – *James Hardie/Long International* and Decision No. 530 – *Bondor/Long International,* brick veneer and so on);

(b) flooring (in competition with particle board, timber strip and concrete);

(c) structural, which includes roofing and decking (minimal), furniture making, and marine applications (in competition with MDF, particle board, fibre cement, hardboard, plasterboard, veneer overlay eg Melamine, Oriented Strand Board ("**OSB**"), strip timber and corrugated iron);

(d) manufacturing/materials handling (ie packaging, in competition with steel bins, timber packaging solutions and plastics).

11.5 The Commission would not appear to have addressed plywood specifically since Decision No. 213 (*Re Fletcher Challenge/NZ Forest Products*) in 1987, when it generally identified the relevant market as being (paragraph 105) "the manufacture of various types of wood-based panel products for use nationwide in a variety of applications". The Commission adopted a submission that the wood-based panels industry should be viewed in the context of the associated end use markets (the key one for consideration there being flooring panels and, in particular, the impact in respect of the residential flooring construction market). The applicant generally concurs with that approach. Plywood competes in a range of specific end use categories and in all cases is one of a number of competing substitutes. The key influencers/decision makers in specification of plywood versus alternatives are developers, architects/designers, engineers, builders, and home owners. A reduction in plywood's price competitiveness in any particular segment will drive changes in consumer/specifier preference (the same point being noted in Decision 412 at paragraph 53 regarding the cladding products under consideration there).

11.6 However, it should be acknowledged that a broader market definition is also sustainable in light of Decision 431. In that decision, which involved MDF and the observations in paragraph 11.3 above as to why a limited approach was justifiable, the Commission nonetheless recognised there were good arguments for a market defined simply as that for "construction materials". The grounds for such a broader definition are stronger here, given the absence of the limiting features of that decision as noted above and that plywood is used and substitutable in a wide variety of construction applications. Ultimately, the applicant is of the view that nothing should turn on which approach is taken, they both being descriptive rather than prescriptive tools of analysis. In effect, the multiple end-uses considered comprise sub-sets of a broader construction materials market, in each case there being a number of substitutes, and the result is the same however it is approached. The High Court's decision in *Brambles New Zealand Limited v Commerce Commission* ((2003) TCLR 868) reinforces that market definition is only a tool, and that all relevant constraints must be considered, regardless of what market definition is adopted. A number of the end uses of plywood are set out in Appendix 1.

11.7 In summary, possibly relevant end-use markets relating to plywood impacted by the proposal are:

(a) Flooring construction;
(b) Architectural claddings;
(c) Structural;
(d) Packaging.

11.8 The proposal also involves the acquisition of the Ramsey Roundwood mill, which manufactures a number of roundwood products. These are used in a number of applications, including rural fencing, retaining walls, horticultural supports and house construction. End users of these products are builders, (domestic, rural and commercial), farmers, vineyards and other horticulturalists, contractors and infrastructure companies and landscapers (including DIY). As a result, most of the product is distributed through both traditional builder merchants and dedicated rural supply merchants (eg Wrightsons). The applicant estimates that approximately 80% of its present sales of roundwood products occur in the region between Turangi and the Bombay Hills. While a number of the larger producers supply over a greater geographical area, there are numerous local producers as well (including South Island producer Goldpine in the Lower North Island ("**LNI**")). For the purposes of the present application, the market definition can be limited to the North Island.

11.9 Finally, in Decision 431 the Commission also identified relevant regional markets for the supply/acquisition of wood fibre. It is not clear whether that was motivated more by the fact that both parties in that clearance application were owners of forests as well as processors (whereas in the present application, Tenon is in the final stages of the disposition of its forests, and the applicant has also announced its intention to dispose of approximately one third of its forests). To the extent that that approach was motivated also by consideration simply of aggregation of activities as an acquirer, regardless of vertical integration, it is submitted that the Commission should be as untroubled in this application as it appeared to be in that. The impact on wood fibre flows by virtue of the present proposed acquisition should be neutral at worst. There has always been an over-supply of logs for domestic consumption, and that is increasing. In the last few years also, there has been disintegration of ownership between forestry and processing assets, which is likely to continue, including forests owned by the applicant as discussed above.

11.10 Accordingly, in summary the relevant markets appear to be:

(a) The production and supply of sawn timber in the North Island;

(b) The production and supply of plywood into national markets for:

(i) flooring construction;

(ii) building cladding;

(iii) structural uses in construction;

(iv) packaging.

(c) The production and supply of roundwood products in the North Island.

Market size and aggregation

Sawn timber

11.11 The applicant's estimate of the size of the market for sawn timber in the North Island is [ ]. Of that, the applicant presently produces approximately [ ] and the Tenon sawmills proposed to be acquired produce [ ] (representing [ ] and [ ] of the total respectively, making a combined total of [ ]). Significant additional domestic market capacity exists, due to the ability of producers to divert export production and increase production through additional shifts. Since Decisions 426 and 467, the number of the applicant's North Island sawmills has reduced from four to two (Kopu and Putaruru), having closed Tokoroa and sold Rotorua sawmill.

11.12 The proposed acquisition is accordingly within the first of the Commission's safe harbours. There is also more competition now than there was at the time of Decisions 426 and 467, insofar as in addition to the large independent sawmills present and identified by the Commission then, new sawmill capacity is being added (eg Ernslaw One in the Coromandel, TDC in Northland, and potentially the applicant at Kinleith or Marsden Point), as set out in section 16 below.

Roundwood

11.13 The market size for the production and supply of roundwood products is estimated to be [ ] (based upon a June 2002 market study by Acumen, a subsidiary of TNS Research) of which [ ] is produced in the North Island and [ ] in the South Island. The applicant produces [ ] of roundwood products per annum in the North Island, giving a market share of approximately [ ]. Ramsey Roundwood has a market share of approximately [ ], making a combined total of [ ]. Other major competitors' North Island market shares are estimated as follows (there are many more producers than are reflected in this table):

KTT	[ ]
Crofts	[ ]
Mt Pokaka	[ ]
Hautapu Mill	[ ]
Tuakau	[ ]
Permapine	[ ]
Les O'Leary	[ ]
Mitchpine (Foxton)	[ ]
Value Timber (Inglewood)	[ ]
Santofts (Bulls)	[ ]
Taranaki Timber (New Plymouth)	[ ]
Pitzacs (Wanganui)	[ ]
Ruahine Timber (Waipukerau)	[ ]

11.14 As above, the proposed acquisition is within the first of the Commission's safe harbours. However, further information as to the competitive landscape is also provided in Part III below.

Plywood

11.15 There are three New Zealand manufacturers of plywood, producing volumes for the New Zealand and Australian markets as follows:

M^3	Aust	NZ	Total
CHH	[ ]	[ ]	[ ]
Tenon	[ ]	[ ]	[ ]
IPL	[ ]	[ ]	[ ]
Total	[ ]	[ ]	[ ]

11.16 International Panel and Lumber (West Coast) Limited ("**IPL**") owns the brand name "Tuffply" and is active in both the South Island and North Island. It is estimated that IPL distributes approximately one third of its production in the North Island.

11.17 In addition, approximately [ ] per annum of plywood is imported into New Zealand, mainly from Chile and China, representing [ ] of overall volume sold in New Zealand. This trend appears to be in the early stages, growing annually (imports have increased by 47% since 2000), and following the experience of Australia where approximately [ ] of its total plywood market demand is satisfied by imported plywood products.

Year	Quantity (m3)	Value (NZ$000)
1996	[ ]	[ ]
1997	[ ]	[ ]
1998	[ ]	[ ]
1999	[ ]	[ ]
2000	[ ]	[ ]
2001	[ ]	[ ]
2002	[ ]	[ ]
2003 p	[ ]	[ ]

p = provisional

11.18 There are four known plywood importers within New Zealand:

(a) Independent Building Supplies ("**IBS**");

(b) Nickels & Maher;

(c) Plytec International;

(d) Gibson Veneer.

IBS sells to both merchants and users while the other players sell direct to builders. Approximately [ ] of CHH's current plywood sales in New Zealand are via merchants, (eg Carters, Bunnings, ITM), the balance being packaging grade product which is supplied directly to end users, eg pallet manufacturers, onion bin and milk fat packaging.

11.19 Estimates of market size and aggregation in respect of the markets identified in paragraph 11.7 above, follow.

-flooring

11.20 The timber segment of the flooring market is estimated at [ ], of which plywood represents approximately [ ] ([ ] of this segment, [ ] attributable to CHH and [ ] attributable to Tenon). This segment is dominated by particle board (approximately [ ] of timber flooring). Of that, approximately [ ] to [ ] is attributable to CHH (Tenon does not produce particle board). The major producer is Fletcher Wood Panels, at [ ]. The balance of the [ ] is made up by Juken Nissho with "Tri-board" produced in Northland.

11.21 However, as the Commission noted in Decision 213, commercial flooring (presumably encompassing "industrial" too) is predominantly constructed out of concrete, and residential flooring is approximately 40% concrete with the balance primarily comprising particle board (although that percentage was used in Decision 213, the applicant's data indicates a percentage closer to [ ] - see paragraph 16.18). Accordingly, taking into account CHH's current particle board and other timber flooring shares, the aggregation

of Tenon's plywood share would lead to a post-acquisition share of timber flooring at worst of approximately [ ] to [ ], and of the total flooring market (taking into account concrete) of less than [ ] in commercial and less than [ ] in residential. Whilst particle board and plywood complete loosely in the same segment, there is significant differentiation based on the inherent performance properties of each. Plywood has higher span and load bearing properties based on its construction method (which also make it a more expensive product to produce). Its ability to be treated also gives plywood some advantage for wet areas. For these reasons, plywood is positioned at a premium to particle board. CHH Kopine particleboard flooring is sold to merchants for between $40 and $46 per sheet. The equivalent Plyfloor product from CHH's range is sold to merchants for between $56 and $62 per sheet, (a premium of between 22% and 55%). Because of this, plywood remains a small part of the flooring market, limited to areas where consumers are willing to pay for its specific performance characteristics.

-cladding

11.22 Plywood claddings compete primarily in the residential segment of the architectural claddings market. The estimated size of this segment is approximately [ ], dominated by brick veneer, but also includes weatherboard, plaster and monolithic claddings. The combined plywood share of the claddings market post-acquisition, is estimated to be [ ] (CHH presently [ ]). CHH also produces radiata weatherboard, but this is increasingly being displaced by James Hardie "Linea" fibre cement weatherboards and other competing timber products. CHH's share of "New" dwellings and "Additions and Alterations" is estimated to be [ ] combined (see tables in paragraph 16.14 below). Accordingly, post-acquisition the combined market share including plywood and radiata weatherboard is estimated to be no more than [ ].

-structural

11.23 It is difficult accurately to assess much of this segment given the vast range of end use applications and potential substitutes. Typical end uses include:

- DIY
- bracing
- hoardings
- theatre sets
- furniture and joinery
- rural outbuildings
- civil construction/major projects
- transport
- roofing and decking

11.24 In all applications, competing substitutes are available in the form of MDF, particle board, fibre cement, hardboard and plasterboard, veneer overlay (eg Melamine), strip timber, steel and corrugated iron.

11.25 The applicant is unable to assess market shares but is confident that its post-acquisition share will not be of competitive concern.

-manufacturing/materials handling

11.26 Approximately [ ] of CHH's production is sold into these end uses, but this still makes it a very small player. In most instances, product is supplied direct to manufacturers who in turn provide packaging solutions to major industries (eg Fonterra for milk fat packaging) and vegetable exporters (eg onion bins). Packaging is an input cost that

manufacturers wish to minimise so price is critical. Packaging is also used for export, which historically has been dominated by steel bins and timber packaging solutions.

11.27 Post-acquisition, CHH's share of plywood-based packaging would roughly reflect the figures in paragraphs 11.15 to 11.17 above, ie approximately [ ], with IPL approximately [ ] and imports approximately [ ]. However, in each end use there are ready substitutes such as those referred to in paragraph 16.25 below, and although the market share which plywood comprises is impossible to calculate, it is estimated to be less than [ ] of the total packaging material utilised.

12. Differentiated or standardised product markets

12.1 All product markets can be said to be largely undifferentiated (especially roundwood). It is a given that the product has the requisite design characteristics (ie that it can do the same job as a substitute) but, subject to that, the characteristics of particular products can in some situations influence the decision to buy (eg design/aesthetic considerations may influence selection of products for residential internal finishes). While producers attempt to mark their products out, kiln-dried treated timber of various grades, for instance, is a common product. Overall, as the Commission considered in Decision 467 (paragraph 79), "although products are differentiated to some extent, the products are not so differentiated as to affect the market definition."

13. Indicia of differentiated product markets

13.1 **Within** roundwood and sawn timber markets, products are undifferentiated (except in respect of the latter, it is acknowledged that there is differentiation "according to the purpose for which [sawn timber] is intended eg framing, furniture or packaging" (Decision 467, paragraph 78). A similar observation could be made regarding plywood. For instance, for cladding purposes plywood is band sawn finished with a ship lapped edge, roofing has a tongue and groove system and flooring has the same but with a different veneer composition for load performance). Branding (eg "Laserframe" or "Origin"), and marketing in general, has some (but limited) impact, technical specifications are common, and no real distinctions can be drawn based on packaging, warranties, distribution channels or other factors (despite efforts made by suppliers to do so).

13.2 Differentiation occurs **between** structural timber and other framing systems, the purchase decisions being based on a number of factors including installed cost, and characteristics such as appearance and weathertightness concerns. Similarly, in respect of appearance timber, differentiation can occur to an extent in some applications (but fundamentally it competes on price), eg timber weatherboards vs fibre cement and other claddings, timber mouldings vs MDF (the former can be preferred if there is a risk of moisture ingress) vs no moulding at all (modern design trend towards negative detailing). [ ]. Plywood generally competes on price, set according to the value proposition of each product within the segment they compete in (although, like all the products the subject of this application, the decision will involve a blend of other factors too, such as design appearance/aesthetics, etc). [ ].

13.3 There is niche marketing to the extent that particular products are marketed to particular end uses, eg tongue and groove plywood for roofing. But that is always in competition with other products suitable for the same end use (roofing). It is not simply a matter of marketing plywood in competition with other plywood.

13.4 **Close substitutes:**

Roundwood: - other roundwood suppliers.

Sawn timber: - other sawn timber suppliers;
- MDF for mouldings;
- Fibre cement, plaster, monolithic claddings, bricks, blocks, steel, concrete.

Plywood: - other claddings (weatherboard, plaster, monolithic, claddings, brick)
- other flooring: particle board, concrete, timber strip;
- other roofing: concrete, tiles, steel etc;
- other packaging: plastic, steel, wood;
other structural: MDF, particle board, fibre cement, hardboard, plasterboard, veneer overlay, OSB, strip timber, corrugated iron.

13.5 The merged entity would continue to be significantly constrained in its actions by the presence of a number of other suppliers in all relevant markets.

14. Vertical Integration

14.1 No issues of vertical integration arise (insofar as Tenon's upstream and downstream links – with Placemakers, for instance – are contractual only). Although the proposed acquisition will increase the processing assets of the applicant which are able to consume logs from its own forests, there will be no impact on overall wood fibre flows in the North Island.

15. Prior wood product industry Commerce Commission decisions

15.1 The applicant is aware of the following relevant decisions:

(a) Decision 213 (*Re Fletcher Challenge / NZ Forest Products*).

(b) Decision 412 (*James Hardie / Long International*).

(c) Decision 426 (*CHH / CNIFP*).

(d) Decision 431 (*Nelson Pine Industries / Rayonier MDF*).

(e) Decision 468 (*Fletcher Challenge Forests / CNIFP*).

(f) Decision 530 (*Bondor / Long International*).

15.2 The Commission has had occasion to consider other proposals relating to forestry in New Zealand (eg Decisions 224,226,227,228,342), but they appear to be of little, if any, relevance to this application.

PART III: CONSTRAINTS ON MARKET POWER BY EXISTING COMPETITION

16. Existing competitors

Sawn timber

16.1 There is a range of suppliers of competing products in the sawn timber market, with approximately 200 sawmills in the North Island. Of these, a large number produce structural timber for sale in the domestic market. Mills are of various scale, from producers with only local influence to others with much greater capacity and distribution capacity throughout the North Island. Recent experience (noted in section 17 below) has demonstrated the ease with which mills can switch from production of appearance

grades into structural grades and back again, as market circumstances dictate. Smaller mills can have their own competitive advantages (as the Commission appeared to recognize in Decisions 426 and 467) due to more flexible cost structures enabling them to raise or lower their variable costs as they raise or lower their production, as market circumstances allow.

16.2 This has also been facilitated by recent changes in the NZBC (B_2 / AS_1) and an industry wide review of grading instigated by the 5 major merchant groups. In the structural segment, specifiers and end users traditionally had a range of possible timber framing options in combinations of machine stress graded vs visually graded product, kiln dried vs wet, treated vs untreated. Differences in timber offerings based on strength and stiffness performance have now been removed. This was done by establishing an industry grading and verification regime which is reflected in two Draft NZ standards – DNZ3603 and DNZ3622. DNZ3603 establishes the engineering properties attendant to the five MSG (machine stress graded) grades – MSG6,8,10,12,15, two verified visual grades – E8 and E10, and one unverified visual grade – unverified No1.

16.3 Producers can produce the grade(s) of timber they believe fit their customer requirements and the log resource they produce from. DNZ3603 makes a distinction between verified product and unverified product and requires designers to discount the engineering values for the unverified No1 by 25%. However, it also has put the MSG8 and E8 at the same performance level and likewise the MSG10 and E10. The effect of these changes has been to make producers decide if they wish to invest in capital equipment to machine stress grade and/or testing equipment to verify their output. Currently, outside Tenon and CHH, 5 producers have invested in machine stress graders and are now in the market offering MSG graded product. Many more have bought and are in the process of commissioning or are intending to buy in the near future. Previously there were only two producers in this space, CHH and Tenon. It is estimated that by mid 2005 there will be 10 or more mills producing MSG of various grades and that there will be many people producing a verified visual product. The dominant grade used in the market will be MSG8 or the E8 verified visual product. Competition will continue to be intense.

16.4 Examples of competitors that have entered key markets such as Auckland with stress graded product in the last 18 months are Red Stag and TDC.

16.5 TDC is based in Whangarei and currently distributes as far south as Cambridge, having won business with [ ]. TDC is also forming an alliance with Lumbercorp, a timber treatment contractor, to store and distribute its product in the BOP region. Red Stag produces MSG product at its Waipa site and supplies to stores in Auckland market. WPI, a significant producer in the lower part of the North Island also produces MSG product and sells in major markets such as Auckland, Wellington and though the Waikato / BOP.

16.6 While Auckland is the largest market and is as a consequence highly competitive, the LNI has many more mills supplying into it. The competitive set is a mix of local and North Island wide producers. People like Fielding Lumber, Davis, Taranaki and Waverly Sawmills, all LNI producers, provide good volumes of structural product into targeted customers in various parts of the region. In addition, Nelson / Marlborough sawmills supply into the North Island. Ernslaw One has been granted resource consent to build a mill on the Coromandel Peninsula. This mill comes on stream in 2006 and will utilise about 180,000 tonnes of logs.

16.7 In the month of August Moxon Timber began selling Baltic pine, a European species timber, in NZ. Stora Enso of Europe is the supplier of the timber. [ ]

16.8 [ ]

16.9 In addition, timber competes with other products in all applications. For example, in the structural segment, it competes with other wall construction methods (similarly, in the appearance segment, competing with other wall finishing methods and other claddings).

16.10 In summary, the same factors which influenced the conclusions in Decisions 426 and 467 continue to operate, but even more strongly as the New Zealand wood fibre industries continue to evolve:

(a) There are still several large independent sawmilling operations which will offer competition to the merged entity: TDC, Lakesawn (Pederson), Pan Pac, Tachikawa, WPI, Juken Nissho, Red Stag. In addition, Ernslaw One is to develop a sawmill on the Coromandel Peninsula which will have an annual production volume of 180,000m^3; and TDC has commenced a 5 year plan to increase their annual production volume in Whangarei from its current capacity of [ ] to a potential capacity of approximately [ ] (a large percentage of which is intended for export).

(b) As has been predicted for some time, log volumes are increasing. While forest owners can to an extent moderate the level of harvest, generally speaking New Zealand produces more logs than it can process and consume domestically, and this trend is increasing. Either those logs are exported or they are processed locally, either for local consumption as sawn timber or for the export of sawn timber as a higher value product than logs.

(c) The different cost structures of smaller sawmilling operations noted in those decisions as giving niche competitive advantages, still apply, but the point is even stronger now by virtue of the change in specifications for MSG, as noted above, providing technical uniformity and easier access to distribution by smaller players.

(d) There continue to be no significant barriers to entry and, as noted in those decisions, potential competition can still be said to be likely to provide additional constraint.

(e) If anything, the constraint in those decisions as being provided by the countervailing power of purchasers (large building supplier merchant chains) is greater given that Carters is the only vertically integrated merchant, Placemakers is the largest merchant and is independent.

(f) Disintegration of forestry ownership from the ownership of processing facilities which has occurred since those decisions, is likely to continue.

Roundwood

16.11 Roundwood is one of the most competitive markets for timber products. Log supply is not an issue, they are easy products to process from logs and access to chemical treatment is straightforward. Barriers to entry are low. There are two main components of Roundwood manufacturing: log peeling and treatment. The peeling aspect is a straightforward, relatively low-tech process which could be readily established for minimal investment ($100,000 - $200,000). Establishment of a treatment facility is more complex and costly, with a range of compliance issues. However, treatment capacity is widely accessible through a large number of established operations offering third party treatment options. There are approximately 15 treatment facilities in the North Island, each with a capacity to handle volumes above 6,000 m^3 of roundwood every year. Examples of operations that focus on contract treatment include Papakura Treatment, Lumbercorp (Te Puke & Ohinewai), Bay Treatment (Rotorua), Feilding Lumber, Eastown (Wanganui) and Custom Treatment (Taupo). A large percentage of treatment providers offer some level of contract treating outside their own downstream processing. The

Roundwood market is currently crowded with more than 20 producers in the North Island alone. These producers are generally well positioned so freight costs are low. Shipping from the upper South Island to the LNI is not unusual as freight costs are relatively low compared to rates from the North Island to the South Island.

Plywood

16.12 As set out in paragraphs 11.15 to 11.19, IPL is a local manufacturer of plywood, plus imports (currently at [ ]) are steadily rising. The merchant community would have little difficulty in seeking alternative supply from Australia. [ ] IBS, a business established by an ITM member with outlets in Auckland and Hamilton, is active in plywood imports which it distributes through those outlets and into a range of independent merchants across New Zealand. There are a number of plywood producers in Australia, and the two major ones, Boral Hancock Plywood and North Coast Plywood Products Pty Ltd (Norply), could readily import plywood into New Zealand. There have been several examples of major construction companies importing from further afield based on either price or product performance. Mainzeal is one such company that in the past imported product from Indonesia based on price, and from Australia based on performance specification.

16.13 Plywood competes in a range of specific end use categories (refer to Appendix 1). In almost all cases, plywood is one of a number of competing substitutes. The key influencers/decision makers in specification of plywood vs alternatives are developers, architects/designers, engineers, builders, and home owners. A reduction in plywood's price competitiveness in any particular segment will drive changes in consumer/specifier preference.

-architectural claddings

16.14 Plywood claddings compete primarily in the residential segment of the architectural claddings market, which totals approx [ ]. This market is dominated by brick, but also includes weatherboard, plaster and monolithic claddings. CHH is the largest plywood cladding producer due to brand strength; however, CHH's share of the overall cladding market is approx [ ]. Combined plywood industry share, per below, is approximately [ ]. CHH's share in radiata weatherboards is estimated at about [ ] of New A & A combined.

New Dwelling Claddings – Market Share
June 2004 Qtr

	% Share
Cedar WB	[ ]
Radiata BW	[ ]
Ply sheet	[ ]
Clay brick	[ ]
Fibre Cement	[ ]
Stucco	[ ]
EIFS	[ ]
Other	[ ]
Total	[ ]

A&A Claddings – Market Share
June 2004 Qtr

	% Share
Cedar WB	[ ]
Radiata BW	[ ]
Ply sheet	[ ]
Clay brick	[ ]
Fibre Cement	[ ]
Stucco	[ ]
EIFS	[ ]
Other	[ ]
Total	[ ]

Source: BRANZ

Plywood share of this segment has enjoyed modest growth recently with extensive marketing. Historical analysis reflects lower share.

Exterior Cladding Materials Used (per consent stats)

	2002	2000	1999	1997	1994

Plywood Cladding	[ ]	[ ]	[ ]	[ ]	[ ]

Source: NFO NZ New House Survey 2002

16.15 No issues arise, for the same reasons noted in paragraphs 42, 53 and 79 of Decision 412:

> ... many other exterior building claddings are available [Footnote 10: For example, glass, fibre cement sheets, brick veneer, steel, timber, concrete slabs and concrete blocks].
>
> …the various other types of architectural cladding are also part of this market. The substitutes are listed in table 9.13 of the application. …. While in some cases polystyrene-based architectural cladding was used for its aesthetics, lightness, ease of erection or low cost, in other cases glass, steel, wood or fibre cement products were preferred by architects and builders…in this market, orders flowed from competitive tenders and it had to be price competitive against other types of architectural cladding if it was to win tenders.
>
> There is minor aggregation in the New Zealand market for architectural cladding. However, given that there are at least 12 competitors in the market, with no participant having more than 20% market share, the Commission considers that the effect of the aggregation is no more than minimal and that no competition concerns will exist in that market should the proposed acquisition occur.

16.16 Any of the competing manufacturers could (and would) increase supply if the applicant sought to increase the price of plywood.

-flooring

16.17 The total timber flooring market is estimated at [ ]. Based on latest available data below, plywood flooring represents approx. [ ] or [ ] of this market. CHH Plywood's share of the total timber flooring markets is approximately [ ]. The balance of the [ ] is shared between Tenon and IPL.

16.18 Plywood, as a total of the overall flooring market including concrete, is approximately [ ]. There are numerous substitutes available in this segment, which is dominated by concrete and particle board.

Floor Types – sq metres area
June 2004 Qtr

	Sq metres (000) Timber (1)	All Floors	Timber %
New Dwellings	[ ]	[ ]	[ ]
Dwelling Additions	[ ]	[ ]	[ ]
Garage / Carports	[ ]	[ ]	[ ]
Other Additions	[ ]	[ ]	[ ]
Non-residential	[ ]	[ ]	[ ]
All Buildings	[ ]	[ ]	[ ]

(1) Timber includes particle Board / Timber Strip / Ply

P/Board	[ ]
Timber Strip	[ ]
Ply	[ ]
	[ ]

Source: BRANZ

16.19 No issues can arise, for the same reasons noted in Decision 213 and paragraph 11.21 above. Any of the competing manufacturers could (and would) increase supply if the applicant sought to increase the price of plywood.

-structural

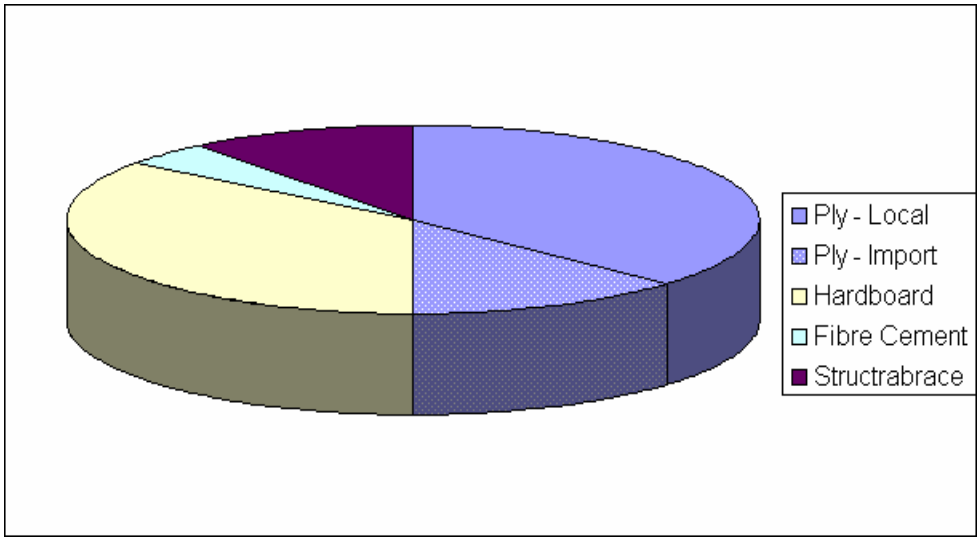
16.20 Approximately [ ] of CHH plywood's production is directed toward structural plywood. Typical end uses include:

- DIY
- Bracing
- Hoardings
- Theatre sets
- Furniture and joinery
- Rural outbuildings
- Civil construction/major projects
- Transport segment
- Roofing/decking

In most applications, competing substitutes are available in the form of MDF, particleboard, fibre cement, hardboard and plasterboard, veneer overlay (eg Melamine), OSB, strip timber, steel and corrugated iron.

16.21 A large portion of structural sales stem from major commercial construction projects, eg stadiums, hotels, hospitals, schools. Such projects are awarded following a competitive tender amongst major construction companies, eg Mainzeal, Fletcher Construction. As noted elsewhere in this application, this is generally true of all building products the subject of this application (except roundwood), and was recognised as a competitive constraint by the Commission in Decision 412 (paragraph 53). These companies generally align to one or more building supply merchants. Significant price increases into the merchant channel for plywood would be met with strong resistance from construction customers who operate in an extremely competitive market, and would prompt product substitution at the specification stage.

16.22 There is one further application within the structural segment, which is bracing. An estimated [ ] of structural volumes are supplied into bracing situations. The applicant has some data on this (see below). This is Australian data, which suggests domestic plywood accounts for [ ] of bracing use. Plywood is a relatively expensive solution for bracing, and considerable pressure is evident to drive costs down, or to find alternatives. The Structabrace product is a particleboard alternative which is new to the market. It is expected that this will drive significant substitution in the medium term, given the favourable pricing.



	%Ply - Local	Ply - Import	Hardboard	Fibre Cement	Structrabrace	
	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
m3	[ ]	[ ]	[ ]	[ ]	[ ]	[ ] = Mkt size M3

[ ]

16.23 Within the structural segment, plywood is also supplied into the furniture manufacturing segment, generally via a merchant. Local manufacturers compete in a competitive global market where price pressure on all input costs is intense. An example of this price sensitivity can be seen with the recent downward price pressure exerted by a major account [ ]. This customer successfully trialled an alternative solution [ ] to leverage down plywood costs. Plywood is also sold via a reseller network. Traders such as IBS and Plywood City operate as stockists breaking bulk and supplying smaller end users. Significantly IBS also import product (see 11.18 above).

16.24 Any of the competing manufacturers could (and would) increase supply if the applicant sought to increase the price of plywood.

-manufacturing/materials handling

16.25 Approximately [ ] of CHH production is directed towards these segments. However, this still makes it a very small player. There are a significant number of substitutes, including timber, plastic containers, rolled paper, bags, steel drums and corrugated cardboard. The market is extremely fragmented and the applicant believes its present market share would be less than [ ]. In most instances, product is supplied direct to manufacturers, who in turn provide packaging solutions to major industries including Fonterra for milk fat packaging, and vegetable exporters eg onion bins (all other vegetable and fruit produce currently utilises other packaging). Packing is an input cost that manufacturers wish to minimise so price is critical. Export packaging has historically been dominated by steel bins and timber packaging solutions.

16.26 Plywood occupies a very small section of this market, in the majority of applications within the horticulture and viticulture segments, a plywood system is not suitable. In the relevant niches, a combination of price competitiveness and service has allowed some inroads to be made over recent years. The materials handling segment remains extremely price sensitive and open to product substitution. Any of the competing

manufacturers could (and would) increase supply if the applicant sought to increase the price of plywood.

CONDITIONS OF EXPANSION

17. Barriers to entry/evidence of expansion

17.1 As increasing amounts of wood fibre become available from New Zealand's growing forest resource, new sawmills are being developed. As the Commission noted in paragraph 291 of Decision 467, "the capital cost of investing in a sawmilling operation is very much dependent upon the scale of the operation." They can be relatively large (eg Ernslaw One on the Coromandel Peninsula) or quite small (from portable, at US$2,500 to US$35,000, to small to medium at $5 to $20 million). The Commission also noted (at paragraph 272 of that Decision) that:

> The capital cost of entry into this market on a small or medium scale is not considered to be a barrier to entry. However, investment in a large scale sawmilling operation would require significant capital expenditure and could be regarded as a moderate barrier to entry.

This last comment needs to be qualified now, since Ernslaw One, at least, is about to build a 180,000m^3 sawmill on the Coromandel Peninsula. Expansion in wood processing assets over the last 5 years has largely been undertaken by small to medium privately owned companies (although investment in the processing industry has, until now, been much less than that applied to the forest growing sector). The projected significant increase in harvest volumes provides scope for significant investment in lumber processing. One such investment which has been underway since May 2004 is TDC's purchase and development of land next to its existing site in Whangarei with the intention of increasing its annual volume from [ ] to a potential production capacity of approximately [ ] over the next 5 years. The applicant has also started planning a new sawmill to be located within the North Island.

17.2 In addition, appearance grade sawmills can with relative ease be converted to producing structural grade timber (which in fact occurred over the last one to two years as a downturn in the US appearance markets drove a number of New Zealand producers to convert to a New Zealand structural cut. While conversion to a MSG regime is a little more involved, the recent simplification of specifications has made it easier. The reverse (conversion of a structural grade sawmill to appearance grade) is much more difficult, however. An example of the ease at which mills can redirect product from US export to the domestic market is TDC. With the decrease in market prices in the US driven by Chilean imports, and the appreciation of the NZD against the USD beginning in late 2002 and intensifying in 2003, New Zealand exporters began to redirect product into the domestic market. For some (including TDC) this meant changing the cut in their mill to a structural cut and placing product into the local market. TDC redirected its entire production of [ ] to New Zealand merchants. This was achieved within a few months and the cost was minimal. Price was the main factor which enabled those firms to gain market share. TDC is now a key player in the domestic structural market with plans to significantly expand its production as outlined above.

17.3 Development of a roundwood operation is cheaper still with the process being relatively low tech and requiring an investment of $100,000 - $200,000 to establish.

17.4 Access to logs will not be an issue. It was not an issue in Decision 467 and the situation has improved further since then, with greater disintegration of the major forest/processing ownership links (a process which is likely to continue).

17.5 Most significant of all, however, is that more than 40% of sawn timber is exported and so significant volumes could be diverted back into the domestic market very quickly if competitive conditions justified it (as noted in Decisions 426 and 467).

17.6 Capital investment required for plywood production on a "Greenfield" basis is estimated to be approximately $NZ30-50m. However, it is not necessary to be producer of plywood in order to participate in the relevant end-use markets, as a range of products compete. The new Nelson Pine Industries LVL facility, however, has demonstrated capability to produce structural plywood using its existing LVL press. To compete with a more extensive range of plywood products, NPI would need to acquire new pressing and finishing equipment. This would be accessible from approx $NZ10m, depending upon age and scale of equipment introduced.

17.7 Juken Nissho currently operates two LVL facilities in Masterton and Gisborne, together with a veneer plant in Kaitaia. The two LVL operations already have the ability to produce plywood, without modification to existing equipment. One plant manufactured ply for supply to the materials handling market. Participation in the mainstream structural plywood markets would require Plywood Association of Australasia ("**PAA**") accreditation. This would be straightforward, as accreditation is currently held for LVL production.

17.8 Production of plywood at the Kaitaia plant would involve additional investment to a similar level of the Nelson Pine Industries example above, ie approximately $10m.

18. Existing competitors who could expand

18.1 All of those identified in paragraphs 11.13, 11.18 and 16.5 to 16.7 above, as well as those supplying non-wood based alternative products into the various end uses the wood-based products the subject of this application compete in.

19. The business decision to increase supply

19.1 The projected ongoing significant increase in harvest volumes is already providing scope for significant investment in lumber processing and business decisions to increase supply are already being made. There is now, and will be more in future, sufficient capacity in all markets (roundwood, sawn timber and, with investment, plywood) to allow supply to the domestic market to increase in response to a *ssnip* by the merged entity. In addition, timber supply can be increased to the domestic markets by diversion from exports. Suppliers of competitive substitute products in the various end uses for plywood are also believed to be able to increase supply if competitive conditions justify it.

20. The time required for supply to increase

20.1 Export diversion for timber can occur within months and increased production can also occur within the same timeframe, by additional shifts/manpower. It is believed that roundwood production can also be increased within a few months by additional shifts/manpower. Upgrading LVL plants or adding capacity to produce plywood would take up to 12 months, but increasing imports of plywood could occur within months. In respect of the myriad substitutes with which the various products compete in all their end uses, it is difficult to estimate how quickly they could increase supply but there is no reason to believe it could not occur within the appropriate competitive timeframe.

21. Constraint provided by possible increased supply by competitors

21.1 As considered above, the merged entity would face considerable constraint from the threat of increased supply in any end use in which the various products compete.

22. Overall constraint by existing competitors

22.1 High.

COORDINATED MARKET POWER

23. Characteristics post-acquisition facilitating or impeding coordination effects

23.1 Collusion is highly unlikely to reduce competition in any relevant market as a result of this acquisition. There will continue to be many independent suppliers of sawn timber and roundwood, and many suppliers also of alternative products in their end uses and in the end uses for plywood.

23.2 In the past, this question has largely been directed towards the likelihood of collusion between CHH and Fletcher interests. In light of this application, which would see a merger of these two processing interests, the prospect of collusion between these two participants can no longer be an issue. As to whether there is likely to be increased scope for co-ordination with all the other suppliers in the markets, there should be no change in respect of sawn timber (see paragraph 265, Decision 467) and roundwood.

23.3 In respect of plywood, while the number of local producers will reduce from three to two, imports and competition from alternative products in all end uses will prevent effective co-ordination. The point made by the Commission in Decision 213 (paragraph 117) is as pertinent now as it was then, namely, it is impossible for a plywood manufacturer to segment its market by isolating one part of the business it supplies from another (ie price discrimination). Plywood of a particular specification used in one application has the same price as the same specification of plywood used in any other application.

Summary

Sawn timber

High seller concentration: No
Undifferentiated product: Yes
Static production technology: Relatively
New entry slow: Not really, slower if de novo, but not if expansion, and easily variable capacity.
Lack of fringe competitors: No
Acquisition of maverick business: No
Price inelastic demand curve: No
Industry competition record: No history of anti-competitive behaviour and vigorous competitive activity in all markets. Industry fora primarily used by independents, eg NZTIF. Merchants, manufacturers, and participants in the building industry join in NZ Building Industry Federation.
Countervailing power: Yes, large merchant chains eg Placemakers, Mitre 10, and at least one trans-Tasman (Bunnings).

Plywood

High seller concentration: Yes in respect of local producers, but no in respect of

building products in the end uses it competes in.
Undifferentiated product: Yes (although differentiated according to the purpose for which product is intended).
Static production technology: Relatively
New entry slow: Yes, if de novo, but not if expansion or imports.
Lack of fringe competitors: No
Acquisition of maverick business: No
Price inelastic demand curve: No
Industry competition record: No history of anti-competitive behaviour and vigorous competitive activity in all markets. NZ Plywood Manufacturers Association.
Countervailing power: Yes, large merchant chains eg Placemakers, Mitre 10, and at least one trans-Tasman (Bunnings).

Roundwood

High seller concentration: No
Undifferentiated product: Yes
Static production technology: Yes
New entry slow: Not really, and expansion easy.
Lack of fringe competitors: No
Acquisition of maverick business: No
Price inelastic demand curve: No
Industry competition record: No history of anti-competitive behaviour and vigorous competitive activity in all markets. Industry for a primarily used by independents, eg NZTIF.
Countervailing power: Yes, large merchant chains eg Placemakers, Wrightsons, Mitre 10, and at least one trans-Tasman (Bunnings).

24. Characteristics post-acquisition facilitating or impeding monitoring and enforcement of coordinated behaviour by market participants

Summary

Sawn timber

High seller concentration: No
Sales small and frequent: Varies: supply contracts with merchants plus tenders.
Lack of vertical integration: Mixed. CHH is presently vertically integrated, and so are some other forest owners, but there are also large forest owners, processors and merchants which are not.
Demand slow growing: No. Construction industry demand can increase (and decrease) rapidly.
Firms have similar costs: No
Multi-market contact: No
Price transparency: Yes

Plywood

High seller concentration: Yes as to local producers but no as to suppliers of competing building products.
Sales small and frequent: Varies: supply contracts with merchants plus tenders.
Lack of vertical integration: Mixed. CHH is presently vertically integrated, and so are some other forest owners, but there are also large forest owners, processors and merchants which are not.
Demand slow growing: No. Construction industry demand can increase (and decrease) rapidly.
Firms have similar costs: No
Multi-market contact: No
Price transparency: Yes

Roundwood

High seller concentration: No
Sales small and frequent: Varies: can be, but also supply contracts with rural resellers and others, plus tenders.
Lack of vertical integration: Mixed. CHH is presently vertically integrated, and so are some other forest owners, but there are also large forest owners, processors and merchants which are not.
Demand slow growing: Steady
Firms have similar costs: No
Multi-market contact: No
Price transparency: Yes

25. Evidence of price coordination, price matching or price following

25.1 None.

26. Reasons why the transaction will not increase risk of coordinated behaviour

26.1 It was not considered likely that co-ordinated behaviour would occur in the sawn timber market before, in Decision 467. There is no reason to believe that the absence of Tenon's structural mills should change that conclusion now. As noted in paragraphs 265 and 266 of the decision.

> Approximately [ ] of the market is supplied by approximately 200 competing sawmills some of which, such as those owned by Pan Pac, WPI, Tachikawa and Juken Nissho, are large. The presence of such a significant number of competitors, coupled with an absence of many other factors required for effective collusion and discipline indicates that the proposed acquisition would not increase the risk of co-ordinated market power in the sawn timber market.

Industry participants spoken to stated that there had been no sign of price co-ordination in the sawn timber market.

26.2 For the same reasons, nor is co-ordinated behaviour likely in the roundwood market. In the plywood business, the presence of significant competing substitutes also makes it unlikely.

PART IV: CONSTRAINTS ON MARKET POWER BY POTENTIAL COMPETITION

27. Potential Entry

ROUNDWOOD

27.1 Barriers to entry into roundwood production are negligible. Minimal capital is required to set up a post and pole operation (see paragraph 16.11 above: ie no more than approximately $200,000). Contract treatment is easy to access and competitively priced, products are undifferentiated and sales are driven by price.

27.2 The only relevant possible barrier is that the existing roundwood market is very competitive, with a large number of producers selling exclusively on price. It is highly unlikely that there would be imports of roundwood. To the extent that market circumstances justify it, it is more likely that an existing producer would expand production to meet demand.

SAWN TIMBER

27.3 *De novo* entry into the sawn timber market is most likely through importation. An example has already been given in paragraph 16.7 above and it is likely that the European supplier referred to could and would develop its market position in the sawn timber market if competitive circumstances justified it. It has already begun on a small scale to develop its customer base and products/price offering. Its success in this regard is likely to provide a good model for others, including Chilean producers, to emulate. Given that at least one international producer has found current market pricing for structural products to be sufficient to justify entry, it is expected that this would only intensify if there were future price lifts of the relevantly significant magnitude. Another key driver of this behaviour will be the actions of New Zealand merchant channels looking to find alternative supply at lower price to increase their market share. A new entrant responding to merchant request could build reasonable share within approximately 18 months.

27.4 At this stage it seems highly unlikely that there would be a *de novo* saw mill entrant into the New Zealand sawn timber market, but with the increasing volumes of wood that cannot be ruled out. It is more likely, as the application sets out, that the existing participants in that market would expand production as the wood fibre flows increase. Hence, Ernslaw One and TDC will both provide increased competition post-acquisition as a result of the capital investment which they are currently pursuing. Timelines for both these projects are public knowledge, with both coming on-stream within the next 2-3 years. TDC will presumably have based its future position on the long term price trend for structural timber, ie a steady decline. It is probably reasonable to assume that Ernslaw One has also modelled returns around a number of scenarios of product mix, market mix and pricing, given the significance of the investment involved. (It is worth noting that in these two instances, even the Resource Management Act 1991 requirements have not proven to be a major barrier to entry for the Ernslaw One “greenfields” site on the Coromandel Peninsula or the new TDC mill in Whangarei expanding on its existing site).

PLYWOOD

27.5 The most likely new entrants would be by way of imports, from those parties mentioned in paragraph 16.12 above. This is most likely to be stimulated by enquiry from New Zealand based or trans-Tasman merchant chains. The overseas suppliers have the scale, product range, PAA participation (product accreditation) and channel management experience to be competitive. A relationship with a merchant channel member in New Zealand could very quickly deliver significant volume to a new entrant at worthwhile margins, while still allowing the merchant to be competitive on price. It is estimated that significant volumes could be delivered within a 12 month period, providing immediate and significant constraint on existing market participants. As the application notes, the trend in New Zealand is likely to follow that which has occurred in Australia, with imports already increasing by significant percentages over the last few years and able and likely to rise further to levels similar to those experienced in Australia (see paragraph 11.17 above). CSR achieved similar objectives in the insulation market in the late 1990's through its relationship with Benchmark/Bunnings.

27.6 This only addresses the constraint from actual or potential plywood competitors. The application proceeds on the basis that plywood competes with a range of substitutes in all applications. The potential for either expansion or entry in respect of all those substitutes is not possible to enumerate. Existing producers of those various substitutes in each of the categories identified in the application expand their production of existing products or develop new products, all the time, as well as new producers entering the market. Examples include the use of fibre cement type weather boards or panels, or zincalume panels, in respect of architectural claddings, or the development of structural grade gib board in applications in which plywood might hitherto have been used).

PART V: OTHER POTENTIAL CONSTRAINTS

CONSTRAINTS ON MARKET POWER BY THE CONDUCT OF SUPPLIERS

Not applicable.

CONSTRAINTS ON MARKET POWER BY THE CONDUCT OF ACQUIRERS

28. Merchants, users

28.1 Building products merchant chains are the primary distribution channel to the ultimate end users for sawn timber and plywood. There are five key merchant chains, namely (with their respective approximate market shares for core building products): Carters ([ ]) (the only one remaining vertically integrated, with the applicant), Placemakers ([ ] - Fletcher Building), Bunnings ([ ]; Australian, owned by Wesfarmers), Mitre 10 ([ ]), and ITM ([ ]). Relative share in the core building products market dictates each merchant's power with end users, and builders hold accounts with several merchants to ensure competitive pricing on quotes, product availability and credit facilities. They have sufficient economic strength (and incentive, through operating competitively against each other) to provide countervailing power. Post acquisition, merchants will still need to compete in the market for core building products.

28.2 For roundwood, products for rural applications are distributed through large retail merchants (eg Wrightsons, RD1) as well as building supply merchants like Placemakers. For construction and utility purposes, supply is a mixture of direct and merchant.

28.3 End users exercise choice over product, from large scale construction tenders through to individual builders. A good example of the constraint they offer is in respect of

structural timber (but the same observations can be drawn from this information in respect of plywood in most applications as well). There are over 13,000 active builders in NZ. They can be divided into 3 categories:

(a) Commercial builders who build large scale projects for both residential and non-residential end use, eg Mainzeal Construction.

(b) Group or Project builders who build large annual volumes of stand alone housing units on either a client by client basis or on a speculative basis. The applicant's categorisation is based on the ability to build more than 24 houses per year as a medium level operator, eg Universal Homes, Spaceline Homes, Golden Homes.

(c) Smaller builders who build less than 12 houses per year. These people typically operate as one builder employing additional unskilled labour or teamed up with one or more additional skilled builder(s) to take greater volumes of construction or larger projects.

28.4 Major construction companies have been and continue to be a key part of the industry. In key markets they are central to high rise and low rise residential apartment developments, non-residential construction such as retail shopping centres, "strip" retail developments, schools, hospitals and government facilities.

28.5 Their method of operation and consequent tender approach to supply creates an environment of maximum competition. This is as true for all building product markets as it was for the architectural claddings market noted in paragraph 53 of Decision 412 (*James Hardie/Long International*). Specifications are defined and then released as part of tender documentation. Tenders are submitted for supply and contracts are awarded. While not the only factor in awarding contracts, price is the most important differentiator given that even small differences in price on the volumes involved has significant margin impact. This is an environment where overall margins for a project are mainly in low, single digit percentages.

28.6 Since 1996 Group Builders (shown below as "Large Housing Company") have increased their position in the market from 20% of the market to 44% in 2003. This number is estimated to be around 55% by year end 2004.

How house was built	1996	1997	1998	1999	2000	2001	2002	2003
Private Builder	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Large Housing Company	20%	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	44%
Owner Builder	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Labour Only	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]

Source: TNS New House Survey 2003

Group Builders have done this on the basis of offering a higher quality home at a lower cost per square metre to the consumer. Delivering this has meant constant pressure on suppliers to hold or improve quality while reducing price in exchange for volume. [ ]

28.7 [ ]:

(a) [ ]

(b) [ ]

(c) [ ]

This approach of annual agreements is becoming more common. In contrast price decreases are negotiated regularly in response to market pressure, and passed on immediately. These decreases are initiated either by supplier discounting to win business or a lack of competitiveness of the specific Group Builder offer to the consumer versus other Group Builders.

28.8 Competition between Group Builders to secure consumer purchase is intense, as they compete to balance cost, quality and speed of construction.

28.9 The growth of Group Builder share of construction has also meant greater utilisation of frame and truss ("**F & T**") manufacturers to supply ready made frames and trusses to site. Currently some [ ] (BRANZ) of all framing is fabricated by F&T plants. There are approximately 160 F&T plants in NZ. A high proportion of this output is used by Group Builders. More significant is the fact that the F&T part of any quote to a builder for materials is used as a measure of competitiveness of the whole quote. It is generally accepted in the industry that a job will not be won unless the F&T pricing is competitive.

APPENDIX 1

The list of end uses for plywood under the structural heading is extensive. Some common applications include the following:

Application	Substitutes
Door manufacturers	MDF, hardwood veneers, solid wood
Sign writers	Veneer overlays, plastics (>50% & growing rapidly)
Cooling towers	Requires structural properties, steel
Toy manufacturers	MDF, solid timber, particle board, plastics
Furniture manufacturers	[ ], MDF, particle board
Truck bodies	Requires structural properties, hardwood ply, steel
Shop fitters & cabinet makers	Solid timber, MDF, laminates, veneer overlays
Boat builders	Imported hardwoods
Single-use formwork	Veneer overlays
Seating grand stands	Solid timber, steel, imported hardwoods
Film settings - TV & movie	Particle board, MDF, timber
DIY - projects, toys, tables, sheds, cubby houses	Solid timber, MDF, fibre cement, corrugated iron
Sound barriers	Concrete
Container floors	Requires structural properties, imported hardwoods, steels
Train bodies - bus bodies - fill for doors & walls etc	Requires structural properties, Imported hardwoods, steels
Construction site usage - walkways, hoardings	Solid timber, fibre cement, corrugated iron, particle board
Caravan & transportable industry - floors, walls, ceilings	Floors require structural properties, walls/ceilings
Stables	Solid timber, fibre cement, corrugated iron, colorsteel
Acoustic wall lining	Gib board, hardwood, fibre cement (villa board)
Shelving - residential & commercial	Particle board, MDF, timber, laminates

The applicant has no reliable data on the split of volumes amongst these categories. What this highlights is that numerous substitutes exist in almost every application. Only in areas where structural performance is critical does plywood offer an advantage. This can still, however, be achieved through high stiffness imported hardwoods, and of course, steel.

THIS NOTICE is given by Carter Holt Harvey Limited ("**The Company**").

The Company hereby confirms that:

- all information specified by the Commission has been supplied;
- all information known to the applicant which is relevant to the consideration of this notice has been supplied;
- all information supplied is correct as at the date of this notice.

The company undertakes to advise the Commission immediately of any material change in circumstances relating to the notice.

Dated this 27 day of October 2004.

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Nicolas W. G. Short

I am General Counsel to the Company and am duly authorised to make this application.