COMMERCE ACT 1986: BUSINESS ACQUISITION

SECTION 66: NOTICE SEEKING CLEARANCE

6 July 2005

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

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

EXECUTIVE SUMMARY

A This application sets out the proposal of Pyne Gould Guinness Limited (*PGG*) and Wrightson Limited (*Wrightson*) (together, the *Applicants*) to effect a merger of their entire businesses. In doing so, the Applicants will be undertaking a process which is crucial to the future well-being of New Zealand's agricultural sector as a whole.

B Agriculture remains the defining sector of this country's economy. This proposal must be seen in the context of the broader benefits which it will bring to that sector, as its participants face growing multinational competitors, increasingly concentrated buyers, more demanding consumers, constant technological change, and an increasingly globalised economy.

C More specifically, the changed dynamics which the agricultural sector now faces include:

(a) Farmers being squeezed between more demanding world markets and higher input costs. In response farms are becoming larger and fewer.

(b) Rural servicing firms being squeezed due to the decline in farm numbers whilst new technology (such as the internet) is increasing competitive pressures and undermining aspects of the traditional rural servicing business model. Efficiency gains must be achieved to improve labour productivity.

(c) New scale being required in R&D if New Zealand is to achieve comparable innovation rates to other OECD countries.

D While these economic considerations provide important context to the rationale of the merger, the purpose of this application is to demonstrate that the proposal will not lead to a substantial lessening of competition in any of the markets affected by the merger.

E Post-merger, all the relevant markets will continue to be characterised by a high degree of competition and, accordingly, the merged entity will continue to be constrained by these competitors. Constraint in this context includes the existence of alternative sales channels, large multi-national competitors, existing large players, as well as a growing assortment of small but dynamic competitors.

F And, of course, the merged entity will continue to be constrained by the combined experience, know-how and astute business practices of the demanding customer it services, being the New Zealand farmer.

PART I: TRANSACTION DETAILS

The Business Acquisition

1 PGG and Wrightson propose to merge by way of a Court sanctioned Scheme of Arrangement under Part XV of the Companies Act 1993.

2 The precise details of the proposed transaction are not yet finalised, but the salient features are as follows:

2.1 Wrightson will be amalgamated into PGG and cease to exist. PGG will continue as the legal entity, and its shares will continue to be traded on the NZSX;

2.2 PGG will change its name to "PGG Wrightson Limited" (*PGG Wrightson*); and

2.3 on merger, PGG Wrightson will issue new ordinary shares to Wrightson shareholders (pari passu with existing shareholdings in Wrightson),

(*proposed merger*).

3 The details of the transaction are set out in the Merger Agreement and the Shareholders' Agreement attached at ***Appendix A***.

4 With regards to timing, the merger proposal will be going to shareholders in mid-August, with shareholder meetings and legal completion scheduled for early September.

The person giving notice

5 This notice is given by:

(a) PGG
411 Blenheim Road
Christchurch

Telephone: +64 3 341 4331
Facsimile: +64 3 341 4322
Attention: Hugh Martyn, Chief Executive Officer

(b) Wrightson
14 Hartham Place
PO Box 50240
Porirua

Telephone: +64 4 918 0740
Facsimile: +64 4 238 0286
Attention: Barry Brook, Chief Executive Officer

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

Chapman Tripp
1-13 Grey Street
Wellington

Telephone: +64 4 499 5999
Facsimile: +64 4 472 7111
Attention: Grant David / Jim Sullivan

Confidentiality

The fact of the proposed acquisition?

7 Confidentiality is not required for the fact of the proposed merger.

Specific information contained in or attached to the notice

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

Details of the Participants

PGG

8.1 PGG is based in Dunedin, and is a rural servicing provider to the South Island agricultural sector. PGG also has limited involvement in the North Island, and a small presence in Australia. Details about the business activities of PGG are set out in paragraph 13.1 below.

8.2 A copy of PGG's 2004 annual report is available at http://www.pgg.co.nz/default.asp.

Shareholders

8.3 PGG is listed on the New Zealand Stock Exchange, with 55.49% of the company's share capital held by Pyne Gould Corporation Limited (*PGC*). PGC is a widely held company also listed on the New Zealand Stock Exchange. PGC will hold approximately 22% of PGG Wrightson, post-merger.

8.4 PGC is a Christchurch-based company involved in rural and financial services. It regards itself as a holding company with an active role in the business in which it has invested, rather than an investment company. PGC's contact details are:

PGC
233 Cambridge Terrace
PO Box 167
Christchurch

Telephone: +64 3 365 0000
Facsimile: +64 3 379 8616
Attention: Brian Jollife, Managing Director

Subsidiaries

8.5 A structure chart for PGG is provided and attached at ***Appendix B***. A list of relevant PGC and PGG subsidiaries are detailed and listed in ***Appendix C***.

9 ***Wrightson***

9.1 Wrightson is a national rural servicing company based in Porirua. Wrightson will be relatively familiar to the Commission from its recent investigation into Wrightson's acquisition of Williams & Kettle Limited (*W&K*). Details about the business activities of Wrightson are set out in paragraph 13.2 below.

9.2 A copy of Wrightson's 2004 annual report is available at http://www.wrightson.co.nz/assets/about%20wrightson/annual_report_2004.pdf.

Shareholders

9.3 Wrightson is listed on the New Zealand Stock Exchange, with 50.1% of the company's share capital held by Rural Portfolio Investments Limited (*RPI*). RPI will hold approximately 30% of PGG Wrightson, post-merger.

9.4 RPI is a holding company for rural investments. Currently, RPI's only significant investment is its shareholding in Wrightson Limited. RPI's contact details are:

RPI
10th Floor
John Wickliffe House
275 Princess Street
Dunedin

Telephone: +64 9 303 3949
Facsimile: +64 9 303 3979
Attention: Craig Norgate

Subsidiaries

10 A structure chart of the Wrightson group, including companies in which Wrightson or its interconnected bodies corporate own 10% or more of the shares, is provided and attached at ***Appendix D***. All Wrightson subsidiaries are detailed and listed in ***Appendix E***.

[ ]

11 **[ ]**

12 ***Formal and informal links between participants***

12.1 The formal and informal links between the Applicants through joint-shareholdings are detailed in ***Appendix F***.

Directorships

12.2 Neither PGG's or Wrightson's directors hold any directorships that are of significance to the current application.

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

PGG

13.1 PGG's core services include:

(a) *Rural Supplies*: PGG operates 43 rural supplies stores throughout the South Island, and also a store in Hastings. These stores supply a wide range of farmer consumables including fencing, apparel, equipment, chemicals, animal health products, fertiliser, seeds and leisure goods.

(b) *Wool*: PGG provides wool brokering services in the South Island.

(c) *Livestock Trading Services*: PGG employs 100 agents who operate throughout the South Island and, more recently, PGG has expanded into the North Island by employing 10 ex-Williams & Kettle agents.

(d) *Seeds*: PGG seeds has a particular emphasis on the breeding and distribution of cereals, turf & amenity grasses; pasture; commodity forage trading; seed production; seed processing and research and development.

(e) *Insurance*: PGG offers a variety of insurance services (pursuant to a power of attorney from Vero).

(f) *Real Estate*: PGG specialises in rural real estate, with branches located in various centres throughout the South Island.

(g) *Bloodstock*: Through its Standard Bred division, PGG conducts the sale of Standard bred horses.

(h) *Finance*: PGG offers a comprehensive range of financial services specifically designed to meet the requirements of farmers.

(i) *Velvet*: PGG is involved in the marketing of velvet through its Velpool division.

(j) *Irrigation*: PGG moved into the irrigation and pumping area in 2003. Operating predominantly in the South Island, PGG irrigation and pumping is involved in irrigation system design, construction, installation and maintenance.

Wrightson

13.2 Wrightson's core services include:

(a) *Rural and Horticultural Supplies*: Wrightson operates 77 rural supplies stores throughout the country, supplying all manner of farm supplies and equipment including animal nutrition products, grain and seed, chemicals, clothing, fuel, fencing, machinery, and leisure goods. In addition, Wrightson operates 35 Williams & Kettle and Fruitfed branded stores throughout New Zealand.

(b) *Wool*: Wrightson operates nationwide wool brokering services, and has a 35% shareholding in The New Zealand Merino Company Limited.

(c) *Livestock Trading Services*: Wrightson manages a variety of relationships between farmers, meat processors, exporters and breeders (including the buying and selling of livestock on behalf of clients at auction, the facilitation and development of supply contracts, and the facilitation of the sale of velvet by electronic tender).

(d) *Seed and Grain*: Wrightson offers a wide variety of seed and grain products for New Zealand climates. Wrightson is also involved in agricultural research in New Zealand, with a focus on plant genetics, seed enhancement and forage animal performance.

(e) *Insurance*: Wrightson offers insurance solutions with particular emphasis on the rural sector through an alliance with Aon New Zealand Limited.

(f) *Real Estate*: Wrightson specialises in rural real estate throughout New Zealand.

(g) *Financial Services*: Wrightson provides a comprehensive range of financial services including loans and credit facilities.

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

14.1 The proposed merger must be viewed against the changing dynamics of farming, both in New Zealand and internationally. New Zealand farmers are being increasingly squeezed between more demanding world markets and higher input costs, especially land and technological inputs. In response, farms are becoming fewer, larger, more specialised and more productive.

14.2 Rural servicing firms, in turn, are also being squeezed from both sides. Not only are customers becoming larger and more demanding, but technological changes have resulted in the advent of new forms of competition. Further, driven by the economies of scale required to fund R&D, the world's largest seed businesses have established a presence in New Zealand, not just to expand marketing opportunities, but also to exploit New Zealand's reputation for combining pastoral science with its practical implementation.

14.3 While those new technologies and new entrants may take a different form, or different identities, in the various markets affected by the proposed merger, the overall effect is the same. Namely, new and increasingly dynamic competition.

14.4 These trends are irreversible and their impact is readily apparent elsewhere. For example, in the 1990's the rural services industry in Australia underwent a well documented period of consolidation. That same phenomenon now is occurring in this country.

14.5 It is vital that such changes be viewed in their proper economic context. The Applicants therefore commissioned CRA International to prepare an expert report describing the economic drivers of the rural servicing industry, and the changes in them. That report is attached at ***Appendix G***. The report goes on to provide the context for analysing the competition and efficiency implications of the proposed merger.

14.6 While the Applicants are not seeking an authorisation, those efficiency implications are relevant to this application for clearance in two respects. First, they address directly the Commission's question as to the reason for the merger and the Applicants' intention in respect of the merged business.

14.7 Second, to the extent that those efficiencies are competition-enhancing, they are relevant to the changing matrix of markets against which the proposed merger must be analysed. For example, the post-merger rationalisation of rural supplies outlets doubtlessly will provide entry opportunities, in the same way that the divestments which occurred after the Shell/FCE acquisition effectively "unlocked" the New Zealand gas industry to new players. The need for the merged entity to achieve efficiency gains will similarly ensure that vigorous competition will persist post-merger in every affected market.

14.8 More generally, the changes resulting from the proposed merger are intended to improve the competitiveness of New Zealand farmers in those increasingly demanding markets in which they themselves, and their agricultural commodity products, must compete. To the extent that the rural services industries in Australia and elsewhere are already passing on the benefits of consolidation to their farmers, New Zealand farmers are at a comparative disadvantage.

14.9 Indeed, the rural services industry in New Zealand currently is characterised by fragmentation, duplication and under-investment. The key rationale for the merger is to enable the industry to rationalise in light of recent changes in the farming and rural servicing sectors. In particular:

(a) the increasing productivity pressures on farms, and the consequent increase in their size and sophistication as businesses;

(b) changing business models in the rural servicing sector, such as the internet and direct sales;

(c) the dynamic changes that are occurring off-shore to drive down the costs of overseas producers with whom New Zealand farmers must compete; and

(d) the need to achieve economies of scale and scope to attract further investment and improve research and development activities.

14.10 While it is intended that the proposed merger will result in increased value for the merged entity and its shareholders, that will not come at the expense of farmers or competition generally. Rather, the proposed merger will enable the Applicants to reduce costs by eliminating unnecessary duplication in all areas of activity, thereby lowering the prices for farmers and increasing opportunities for R & D, including in seed cultivars. It is not just farmers who will benefit from these innovations. Increasing on-farm productivity through new developments will be passed on to consumers, as the product of top meat-growing breeds — fed on fatter, energy dense grasses, and handled on-farm with conveyor-belt precision for drenching and vaccinating — reach the supermarket shelf. And, of course, some developments in animal science and technology will result in less stress on the animals themselves.

14.11 In essence, the proposed merger represents the only economically rational response available to the Applicants in the face of the changing dynamics described in the CRA report. That response is also entirely consistent with the requirements of future economic policy necessary to improve New Zealand's living standards to the top half to OECD.

14.12 The report "Growth Through Innovation" produced jointly by the Ministry of Economic Development and The Treasury earlier this year, observed:

> *New Zealand can be characterised as a small open economy that is distant from many of the world's markets. New Zealand, however, also has a relatively large agricultural sector by OECD standards, and a significant proportion of our exports is* [sic] *based on primary production. New Zealand has a relatively small share of its production devoted to "high technology" sectors…*[1]

14.13 That report identified two key indicators showing New Zealand presently at the lower end of the OECD range. The first is *labour productivity*, where raising the capital-labour ratio is the key to improvement. The second is *innovation,* which is described as the key driver of long term economic growth. While expenditure on R&D is said to have risen in recent years, it is still well below OECD standards. In particular, private sector R&D expenditure only accounts for 37% of R&D expenditure compared to 70% elsewhere.

14.14 Clearly, the proposed merger has substantial potential to address both these deficiencies by:

(a) eliminating unnecessary duplication of activity;

(b) providing for the consolidation of R&D expertise and the creation of the "critical mass" needed for effective R&D; and

(c) freeing capital necessary for R&D expenditure of sufficient amount and duration to remain competitive in international markets.

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[1] Economic development indicators 2005, Ministry of Economic Development, p. 16.

14.15 In short, the Applicants' shared intention is to create a new business that will combine the existing strengths of both. It is vital that the merged entity achieves the internal efficiencies necessary to meet the increasing competition that it, and its farmer customers, will face in increasingly global markets.

PART II: IDENTIFICATION OF MARKETS AFFECTED

15 Horizontal Aggregation

15.1 The markets principally affected by the proposed merger are:

(a) *Livestock trading services in the South Island*. In particular, the merger will result in the merged-entity:

(i) employing **[ ]**% of the total number of agents operating in the South Island, who together account for an estimated **[ ]**% of all stock currently handled by agents throughout the South Island; and

(ii) acquiring 100% exclusive access rights to or the shares in the companies that own saleyards at, Canterbury Park[2], Owaka and Tinwald (in Ashburton), and increased shares in the companies that operate saleyards in the following areas:

(a) 53% share at Sheffield;

(b) 38% share at Waiareka;

(c) 37% share at Omarama;

(d) 45% share at Palmerston;

(e) 25% share at Balclutha;

(f) 32% share at Omakau;

(g) 42% share at West Otago;

(h) 24% share at Lorneville,

and a few other minor holdings of less than 10%.

(b) *Wool trading services in New Zealand*. The merged entity will control **[ ]**% of the wool sales facilitated by brokers in New Zealand,

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2 Note that Canterbury Park is currently owned by the Canterbury AMP Association. Canterbury Saleyards (1996) Limited lease the facilities and by way of rent are amortising the mortgage raised by Canterbury AMP.

accounting for approximately **[ ]**% of the total wool sales in New Zealand.

(c) *Regional South Island markets for the retail supply of rural and horticultural supplies*. The merger will result in the merged entity currently owning the only full services rural merchandise stores operating in Amberley, Culverden, Fairlie, Geraldine, Kurow, Lawrence, Ranfurly and Otautau.

(d) *The market for research and distribution of forage seed varieties in New Zealand*. The merged entity will hold **[ ]**% of total sales of *proprietary* forage seeds market (this figure is reduced when "public seeds" – which comprise between **[ ]**% of all sales – are included).

Each of these markets is considered in detail below. In addition, the merger will result in minor aggregation in real estate agency services, financial services and general insurance markets. However, that aggregation is insignificant from a competition law perspective given the robust competition from other market participants, including large national firms offering comprehensive services in those areas (such as trading banks, insurance companies and real estate franchises). The Applicants believe that these markets do not warrant any further consideration in the context of this application, but would be happy to provide further details to the Commission in respect of these markets, if required.

16 **The market for livestock trading services in the South Island**

Introduction

16.1 The merger will result in the aggregation of livestock trading services in the South Island. The Commission will be familiar with livestock trading services, having recently considered that market in detail in its Investigation Report into Wrightson's acquisition of W&K dated 21 April 2005 (*W&K Report*).

16.2 There, the Commission found that the relevant market was livestock (including prime stock) trading services in the North Island. The Applicants contend the same product, functional and geographic dimensions are applicable in the South Island.

Market definition

Product Market

16.3 In the W&K Report, the Commission considered the relevant product market to be the market for livestock, including prime stock, store stock, dairy cows, cull cattle and sheep (each of which is considered in detail in that Report). In particular, the Commission noted at paragraph 58:

Industry participants considered that there was not a separate market for prime stock and all livestock companies considered prime stock to be as much a part of their business as any other type of stock.

16.4 The Applicants agree with that assessment of the market. Livestock companies in the South Island treat prime stock as a core component of livestock trading. By way of example, PGG estimates that in 2005, **[ ]**% of its sales will comprise facilitating the direct procurement of prime stock for slaughter. The remainder will be a mix of sales of store and prime stock both in the paddock, and at sale-yard auction.

16.5 Moreover, meat companies in the South Island compete more vigorously with stock and station agents for prime stock than they do in the North Island. The extent of that involvement is discussed in detail at paragraphs 24.3 – 24.4 below.

Functional Market

16.6 The Applicants consider that the relevant functional market is livestock trading services. These services encompass a variety of different relationships between sheep, beef, dairy (and sometimes pig and deer) farmers, meat companies, and livestock importers and exporters. There are essentially 4 sales channels available for farmers to sell stock:

(a) by auction at saleyard;

(b) in the paddock;

(c) by direct procurement; and

(d) private treaty between farmers.

16.7 There are also small numbers of stock sold via the internet. The three primary methods of sale utilised by stock and station agents are saleyard auctions (primarily store stock, but some prime stock), paddock sales (a mix of store and prime) and direct sale to slaughter (prime). In 2003/04, of the sales PGG facilitated, **[ ]**% were at saleyard auction, **[ ]**% were in the paddock and **[ ]**% were direct to slaughter.

16.8 All of these methods of sale are substitutable for one another, with choice primarily driven by sensitivity to cost, climatic conditions and breeding stock requirement. Farmers weigh-up the risks of keeping stock on paddock or, conversely, not finding a buyer at the right time, yard fees, agency fees, procurement schedules, and other factors. A different risk/reward tension may attach to each method of sale for each farmer, and that tension will change from time to time. Generally speaking, however, from the farmers' perspective, saleyards and paddock sales are substitutable for direct sales to meat companies or sale by private treaty. The Commission recognised this point in the W&K Report:

> *Industry participants advised that farmers will switch between auction and paddock sales depending on which method will maximise net returns. Which method results in the best return depends on a variety of factors including supply and demand, availability of grass, and market circumstances.*

16.9 In addition, competition by meat companies for stock is far more aggressive in the South Island. Companies such as PPCS, AFFCO, Canterbury Meat Packers and Alliance have moved away from their traditional role of only procuring prime stock for slaughter, to securing replacement store stock for farmers to ensure a steady supply of stock ready for the slaughter (with no commission charged).

16.10 While meat companies generally control their own procurement and have an extensive network of reps across the South Island, they will utilise a stock and station agent to source stock where an established relationship exists between the meat company and the rural company rep or on the shoulders of the season.

16.11 Switching between various modes of sale for price maximisation is common. In 2003/04, drought conditions led to an increase in paddock sales to minimise the risk of lower prices at auction. Conversely, a higher schedule this year has resulted in an increase in auction sales and direct sales to meat companies in order to maximise price. Other suppliers have an established relationship with a meat company, but will use a stock and station agent where higher prices are on offer. To take only one of many possible examples, **[ ]** from **[ ]** recently sold his entire drop of lambs through a paddock sale, rather than through his usual method of selling to a meat company, simply because of the greater returns generated in that instance.

Geographic Market

16.12 The Applicants consider that the relevant geographic market is the South Island.

16.13 The modern livestock industry is characterised by an increased willingness to transport stock much greater distances. This distance is generally greater in the South Island than in the North, due to the different geography of the South and the more competitive rates offered by South Island transport companies.

16.14 In addition, the increasing value of livestock has reduced the relative cost of transport considerably. It is not uncommon to see stock transported over distances of around 200 km to 300 km to sale. Transacting on a live weight basis has opened up the market to an increased number of participants transacting over a much wider geographic area. There is also some inter-island stock transfer. The extent to which this occurs is dependant on seasonal and climatic factors, but in times of drought these transfers can be significant.

16.15 Buyers meanwhile are often willing to travel further again: as far as 500 km to auction. At the same time, there are an increasing number of transactions for which no-one has to travel. For instance, private sales made through an agent are often made without the purchaser (or their agent) even sighting the animals. **[** **]**.

16.16 While most livestock transactions still occur within 150 km-200 km of the farm, livestock agents will happily travel greater distances if it is profitable to do so. This demonstrates a high degree of price sensitivity, and an equally high willingness of buyers to move within the South Island to the most profitable venue. In the W&K Report, the Commission noted (at paragraph 80 and 81) that livestock agents:

> *…do not have to have a base close to the farm to be able to provide effective service, but rather can travel to regions as required. While traditionally some livestock agents are considered to be stronger in some regions and weaker in others (W&K, for instance, had strong links with the Hawkes Bay and East Coast), they have the flexibility to move quickly to take advantage of opportunities as they arise over wide areas…*
>
> *In view of this factor and the ease with which livestock agents can expand the scope of their operations, we consider that it is not necessary in this instance to adopt separate regional markets.*

16.17 On that basis, the Commission adopted a North Island market. The same factors apply in the South Island.

16.18 Finally, island-wide markets are also consistent with a variety of Commission decisions in the context of meat processing and procuring. For example, in *Decision 441* the Commission adopted the South Island as the relevant geographic market, noting that this was a "conservative approach, consistent with past investigations".

Parties involved in livestock trading

16.19 There are a number of independent businesses that operate livestock trading services both in the paddock and through saleyards (including Rural Livestock which has a team of 14 agents, Peter Walsh & Associates Limited with a team of 9 agents, and Southstock Limited and South Island Dairy Farmers Limited each with a team of 8 agents). A list of agents and meat company agents operating in the South Island, and the relevant market shares for each, are attached at ***Appendix H***.

16.20 There are a number of saleyards throughout the South Island, most of which are held by farmer co-operatives (rather than stock and station firms, as in the North Island). A map identifying saleyards in the South Island is attached at ***Appendix I***, and a chart detailing ownership of saleyards is attached at ***Appendix J***.

16.21 There are also numerous meat companies with their own agents operating throughout the South Island. These include Alliance, PPCS, Canterbury Meat Packers and Progressive, as well as smaller abattoirs and supermarkets. A full list of companies that procure meat directly in the South Island is attached at ***Appendix K***.

16.22 There are a number of independent agents. These agents have very low costs and are able to enter the market with ease. Frequently, they will have previously acted as an employed agent, then chosen to "go it alone", taking a large number of the farmer clients they had formerly serviced with them.

Differentiated product markets

17 While there is significant product differentiation (for example, between sheep and cattle), there is no significant functional differentiation in the livestock trading market.

Vertical integration

18 The proposed transaction will not result in any additional vertical integration in the market for livestock trading services.

19 The market for wool trading services in New Zealand

Introduction

19.1 The Commission's most recent consideration of the wool trading market is in its report prepared on the Wrightson/PGG joint venture agreement to form New Zealand Wool Handlers Limited (*Memorandum from Deborah Rogers to Fritha Mackay dated 15 October 2004*) (*JV Report*).

19.2 There the Commission stated that the appropriate product market related to the sale and purchase of wool, however sold; and that the geographic dimension of this market was national in extent. The Applicants agree with this approach, as contrasted with the approach taken by the Commission in *Decision 436*. In that Decision, the Commission adopted separate markets for auction sales and direct sales (following the applicant's approach) and also dealt with merino wool as a distinct product market.

19.3 The Applicants' approach to market definition is dealt with in more detail below.

Market definition

Product Market

19.4 The proposed merger will involve aggregation in relation to both coarse wool and fine wool (or merino wool) trading services. The Applicants consider that the selling of both types of wool constitutes the same product market.

19.5 As discussed above, in *Decision 436* the Commission considered merino wool in isolation. Certainly, there are some differentiating characteristics between fine wool and coarse wool. Fine wool is (obviously) finer, having a fibre diameter of between 14 and 23 microns compared to an approximate coarse wool diameter of between 31 and 42 microns. Each product also has different end-buyers (fine wool is generally used in fashion garments and apparel, whereas coarse wool is generally processed into carpets and other consumer products).

19.6 Fine wool is handled more than coarse wool, and so commands a higher per bale commission.

19.7 Importantly, however, the functional processes involved in trading fine wool and coarse wool are identical. In other words, the brokering services offered for each type of wool are the same. Similarly, both products are shorn, stored, handled (although – as discussed above - fine wool requires more handling), transported and distributed in the same way. In that respect, wool is similar to livestock trading, which encompasses a variety of different stock types (for example, sheep, cattle and deer), but relates to the same core services – one type of stock is substitutable for another in the context of the services provided.

19.8 Consequently, a person involved in the trading of coarse wool could, with little additional effort, also trade fine wool (and vice versa). There are therefore no significant barriers to wool traders selling either or both grades of wool. As such, the market is properly treated as that of wool trading services.

Functional Market

19.9 The relevant functional level for the purposes of competition analysis is wool trading (including auction sales and direct sales).

19.10 Wool brokers regularly conduct auctions at wool auction facilities that they either own or access via license. The major wool brokers operating in New Zealand currently include Primary Co-op, Southland WB, Central Wool Auctions, Country Auctions, Allied Farmers Wools, and Canterbury Wool Brokers. There are also numerous independent wool merchants. Access to a facility is gained by paying an access fee. Outside of the auction process, wool brokers, wool exporters, wool merchants, and some processors (such as Feltex and Cavalier) purchase wool direct from growers. Wool brokers will buy wool direct from the grower to either on-sell under future contracts, or to put through an auction. This is the most significant sales channel, accounting for approximately **[ ]**% of the wool traded in New Zealand.

19.11 This approach is consistent with the JV Report, which noted at paragraphs 24 to 31 that wool in fact is sold in a variety of ways:

> *24. As noted in the industry background, wool brokers deal with a grower's wool in a variety of ways:*
>
> - *selling wool through auction as an agent;*
> - *arranging a contract between a grower and exporter/end-user as an agent; or*
> - *buying direct from the grower to fulfil their own contracts, (although this occurs only on a minor basis).*
>
> *25. In terms of demand-side substitutability, growers have other outlets to sell their wool. One such outlet is wool merchants, which purchase wool directly from the grower, either by forward contract or on the spot. The wool merchant will then on-sell this wool to the end user, like a carpet manufacturer. Another variation on the wool merchant are exporters, which purchase wool directly from the grower, either by contract or on the spot, and then on-sells the wool to off-shore end-users.*
>
> *26. A grower can also sell directly to an end-user, like Feltex or Cavalier. Growers have the additional option of selling their wool directly to consumers via the internet through a service called Woolnet. Industry participants informed the Commission that although increasing in popularity, internet selling is still in its infancy.*
>
> *27. From the growers point of view, the principle difference between wool brokers (excluding direct buying from the grower) on the one hand, and wool merchants, exporters and direct buying from end-users on the other, are:*
>
> - *a grower's perception as to what mode will achieve a better price; and*
> - *speed of sale. There are time lags when selling through auction compared to a private sale where a grower can shear today, sell tomorrow and then receive payment within 2-3 days.*
>
> *28. In terms of determining substitutability between brokering and the other modes of sale referred to above, the Commission applies the SSNIP test and asks: if the combined firm raises the fees it charges the grower*

between 5-10% or decrease its quality of service, where would a grower turn to sell its wool?

29. Industry participants informed the Commission that farmers would switch to one of the modes of sale outlined above in the face of such a price rise or decrease in quality. It is common for growers to employ a variety of these methods, and switch between them. Therefore, the Commission considers there is very high demand-side substitutability between brokers, merchants, exporters and direct buying.

30. In terms of supply-side substitutability, as merchants, exporters and direct buyers pay growers directly they need to have immediate access to cash, whereas a broker needs no ready cash supply as the ultimate purchaser through auction or via contract is the source of payment for the grower. Despite this difference, the Commission considers that supply-side substitution is very high, as brokers, merchants and exporters and direct buyers are functionally identical as modes of sale.

31. Therefore, considering the high demand-side and supply-side substitution, the Commission concludes that wool brokers, merchants, exporters and direct buyers compete in the same market, that being the market for wool.

19.12 Importantly, the Commission recognised in the JV Report that there is high demand-side substitutability between brokers, merchants, exporters and direct buyers. On the supply-side, the Commission considered that brokers, merchants and exporters, and direct buyers all operate functionally identical modes of sale. On that basis, the Commission considered that both direct sales and auction sales comprise the same market for the purposes of the competition analysis.

19.13 The Applicants agree with this approach and contend it should be preferred to that used in *Decision 436* where the Commission analysed separate markets for auction services and direct sales. In doing this, however, the Commission noted that:

The applicant has considered auction services separately from direct supply contracts. It could be argued that these two activities be combined in a general broking market, as auctions and direct contracts are alternative mechanisms through which farmers are connected to exporters.

Geographic Market

19.14 In both *Decision 436* and the JV Report the Commission adopted a national market for wool trading services. The Applicants see no reason to depart from that analysis in the context of the proposed merger.

Parties involved in the market for wool trading services

19.15 Existing brokers in the New Zealand industry include Primary Co-op, Southland Wool brokers, Taranaki Farmers, Country Auctions, Allied Farmers and Canterbury Wool Brokers. A list of brokers operating in the New Zealand market, and each party's market share, is set out in ***Appendix L***.

Differentiation

19.16 Differentiation does occur to a very limited extent in relation to the treatment of fine and coarse wool. However, this differentiation is not significant and further fragmentation of the market will not aid the competition analysis.

Vertical integration

19.17 The proposed merger will not result in any additional vertical integration in the market for wool trading services.

20 Regional markets for rural and horticultural supplies

Introduction

20.1 The Commission has considered the aggregation of rural supplies stores in both the W&K Report and the Commission's earlier investigation into RD1's acquisition of 19.9% interest in Wrightson (*Memorandum from Whiteside to Thorn dated 12 November 2001*) ("*RD1 Memorandum*"). In both cases, the Commission took a composite approach to rural supplies, bundling all rural merchandise products together.

20.2 As part of the W&K acquisition, Wrightson acquired W&K's interest in Fruitfed horticultural supplies stores. Accordingly, there will also be limited aggregation in various horticultural supply stores, in regions where both parties currently operate. Given the similarity in the functional and geographic markets dimensions of rural supplies and horticultural supplies, the Applicants consider that the same analysis used for rural supplies can be applied to horticultural supplies. On that basis, the Applicants analyse rural supplies and horticultural supplies together below.

20.3 Further, the Commission noted in the RD1 Memorandum that fertiliser constituted a different product market, as it is delivered directly to farmers by manufacturers (such as Ravensdown) rather than through the rural merchandise stores. On that basis, fertiliser is analysed separately from rural and horticultural supplies.

20.4 The Applicants have their own preferred view of the rural supplies market, which they consider could be categorised along individual product lines. Each line faces considerable competition from a variety of competitors (including other full service suppliers, independent retailers and direct sales). However, given the large degree of existing competition in all those markets, the Applicants are willing to acquiesce in the Commission's composite approach to the markets if that will expedite its handling of this application.

20.5 On that basis, the relevant markets are:

(a) Individual regional markets for rural and horticultural supplies; and

(b) the national distribution of fertiliser.

Market definition

Product Market

20.6 The Commission's composite approach to rural supplies (as set out in the RD1 Memorandum) appears to be based on the definition previously used in relation to two dairy company mergers, and the approach taken by the ACCC in Australia. The same composite approach was applied subsequently by the Commission in the W&K report.

20.7 However, the Commission has not gone so far as to view the larger "branded" rural supply stores as a separate market. Instead, in the RD1 Memorandum, the Commission noted that larger rural merchandise stores are not unique one stop shops, but compete with smaller rural stores and other outlets. Indeed, farmers tend to shop around at two or three, if not more, outlets.

20.8 The Applicants consider that the same pragmatic approach should be adopted for horticultural supplies. On that basis, the relevant product market is 'rural merchandise and horticultural supplies'.

20.9 As noted above, the Commission in the RD1 Memorandum treated fertiliser as a separate market from rural merchandise because it is delivered directly to farmers by manufacturers (rather than through the rural merchandise stores), and is national in extent. The Applicants agree with this approach.

Functional Market

20.10 Adopting the functional markets that the Commission used in the RD1 Memorandum, the Applicants contend that the relevant functional markets are the retail sale of rural and horticultural supplies, and the distribution of fertiliser.

Geographic Market

20.11 The Commission has traditionally analysed rural supplies on a regional basis; a similar approach is appropriate for horticultural supplies also. That said, the Applicants contend that this market could easily be considered island-wide in extent due to the increasing importance of 'on-farm' sales made by travelling reps from rural service companies. On-farm sales have broken down the old reliance on stores and consequently regional boundaries have also become defunct.

20.12 Again, consistent with the RD1 Memorandum, the relevant geographic market for fertiliser is national.

Parties involved in regional rural and horticultural supplies, and distribution of fertiliser in New Zealand

20.13 There are a variety of participants in the various regional markets for rural and horticultural supplies throughout the South Island, ranging from large full service operations such as CRT and RD1, to small independent stores and other outlets (such as local veterinarian clinics which may only provide constraint across different product lines).

20.14 A full list of competitors in the various townships is attached at ***Appendix M***. Of course, this table must be seen in context of the large number of other stores which offer the same products in varying product lines. Such stores include hardware stores, clothing stores and wholesalers and include some very significant players such as The Warehouse. These competitors offer very competitive prices and will continue to provide strong constraint to the merged entity.

Differentiated product markets

20.15 Differentiation is not relevant to the Commission's analysis of these markets.

Vertical integration

20.16 The proposed transaction will not result in any vertical integration in these markets.

21 The market for the breeding and distribution of forage seed varieties in New Zealand

Introduction

21.1 Each of the Applicants already has a significant, and increasing, involvement in the various activities that comprise R&D, seed multiplication, and the distribution to farmers, agricultural contractors, retail outlets and others of the full range of forage seed varieties used in New Zealand.

21.2 The Applicants, independently of each other, regard the development of a world class seeds operation, but adapted to New Zealand conditions and aimed at maintaining leadership in the market segments vital to pastoral farming, as core to their respective businesses. Indeed, despite being engaged in the discussions with Wrightson regarding the proposed acquisition, PGG has continued its own long-term expansion plans with the purchase last week of Agricom, a privately-owned seeds business that develops its own proprietary brands.

21.3 That separate venture is referred to because it illustrates two important characteristics of the forage seeds business. First, it is dynamic, with new entrants emerging and alliances between established players evolving. Second, the constant need for new and improved pasture and cereal cultivars has seen major New Zealand suppliers integrating back up the chain to build or buy their own research and breeding capabilities.

Product market

21.4 Obviously, there is a degree of product differentiation between seed species and cultivar varieties. In *Decision 508* (South Pacific Seeds/Yates), the Commission adopted separate product markets for the distribution of the relevant vegetable seed varieties in New Zealand. Further, the Commission held that the appropriate product market delineation should be determined largely by demand side substitution. That is, the ability of farmers to switch to another crop, or type of pasture, in the event of a "snip" in the price of seeds. Farmers readily switch between cultivar brands at the time of sowing.

21.5 However, unlike in *Decision 508* (which related to specific vegetable seeds), there is a greater degree of substitutability between forage seeds. The Commission's approach in *Hodder & Tolley* was to consider these seed products together.

21.6 On that basis, the Applicants consider that the relevant product is forage seeds, the main categories of which are perennial rye grass; short rotation ryegrass; long rotation ryegrass; Italian ryegrass; white clover, Red clover; and brassicas. Lesser utilised categories include tall fescue; cocksfoot; lucerne; and herbs. Each category comprises a number of varieties (for example, kale, rape, leaf turnip, bulb turnip and swede are all brassicas) which are to some degree substitutable for one another.

Functional market

21.7 That integration back up the chain has meant that market participants are engaged in an increasing range of activities than simply supplying and distributing seed. Whereas until the early 1980's as few as 12 government bred "public cultivars" were available to New Zealand pastoral farmer, proprietary pasture cultivars developed by private sector now compromise **[ ]**% of total annual usage.

21.8 No doubt this change prompted the Commission in its 1996 consideration of the *Wrightson/Hodder & Tolley* merger to regard all the following 6 markets as providing an appropriate framework for analysing that proposal. Those markets, which had been proposed by the applicant, were:

- research and development services in seed technology (undertaken by breeders);

- crop contracting and grain broking services (undertaken by wholesalers);
- seed cleaning services (undertaken by wholesalers and independent seed cleaners);
- seed coating services (undertaken by wholesalers);
- wholesale/retail supply of grain and seeds (undertaken by wholesalers and retailers);
- grain drying and storage (generally undertaken by wholesalers and other independent operators).

21.9 To the extent that all those activities are still carried on by both the Applicants, obviously they will be relevant to the current proposal (although PGG notes it is not involved in grain drying or storage). But, it is submitted, so close a dissection of the functional markets is not necessary on this occasion.

21.10 What is most relevant is the ultimate product of all those processes – namely, the breeding and distribution of forage seeds within New Zealand.

21.11 Research is carried out both "in-house" and via contract. Most market participants work with AgResearch and Crop and Food, as well as other research bodies (including Dexcel, Lincoln University, and Massey University). After testing, a successful cultivar is marketed and distributed by wholesalers through their distribution networks.

Geographic market

21.12 Finally, as the Commission found in both the above decisions, all of the relevant markets are national.

Parties involved in breeding and distribution of agricultural seed varieties in New Zealand

21.13 There are a number of existing competitors that undertake germ plasm research (both in-house and via contracted seed breeding programmes) and operate wholesale distribution chains in New Zealand:

(a) Agriseeds Limited (owned by the multinational Royal Barenbrug Group which operates a number of seed companies in Australia, Argentina, North America, China and Europe). Agriseeds specialises in pasture, and claims to have access to technology not available in New Zealand. Previously, Agriseeds was the dominant seeds firm in New Zealand, but has seen its market share diluted over the past decade due to high levels of competition in the market. See www.agriseeds.co.nz for more information on Agriseeds;

(b) Cropmark Seeds Limited, which is involved in all aspects of seed research, multiplication, and distribution throughout New Zealand and internationally. Cropmark is based in Christchurch. See www.cropmark.co.nz for more information on Cropmark; and

(c) DLF Trifolium (a Danish multinational seeds company), which established in New Zealand about 12 months ago. The DLF group is the world's largest producer of clover and grass seeds, describing itself as "one of the market's biggest and most serious partners." DLF has already contract about 3,000 ha of production for the New Zealand and Australian markets. See www.dlf.co.nz for more information on DLF Trifoliam;

(d) Peter Cates Limited (*Peter Cates*), a seed producer and exporter based in Ashburton specialising in brassica, ryegrass, white clover, cereals and amenity grasses. Importantly, Germinal Holdings Limited (the UK's biggest seed production and distribution group) has recently gained a foothold in the New Zealand market by acquiring a 22% shareholding in Peter Cates. See www.germinal.com for more information about Germinal.

21.14 Peter Cates, in partnership with Midland Seeds Limited and Annett Grain and Seed Limited, has established Plant Research (NZ) Limited, which represents "a major share of the New Zealand arable industry and is our countries *[sic]* largest seed distribution network." For more information on Plant Research see www.plantresearchnz.co.nz.

21.15 The market shares for these entities are set out in the table attached at ***Appendix N***. Note that this table does not include data for common seeds.

21.16 There are also a variety of independent operators (such as West Bros Ashburton, Stevens Seeds Limited, McCaw Seeds (based in Methven) , Speciality Grains & Seeds (NZ) Limited and Cridge Seeds Limited) with established international relationships to multiply and distribute branded pastoral cultivars here. Conversely, a large number of northern hemisphere companies enjoy close working relationships with New Zealand seed companies (predominantly in the area of seed multiplication).

Temporal dimension

21.17 While a new cultivar may take between 8 to 10 years to develop (from initial research to market), an existing cultivar can be imported, multiplied and distributed to market immediately. Further, that time lag only applies to a "cold start" situation. In practice, an operator will have successive varieties at different stages of development.

Differentiated product markets

21.18 As discussed in paragraph 21.4-21.6 above, seed varieties and cultivars are differentiated to some degree. Each cultivar is suited to a slightly different purpose. Thus, the choice of cultivar on each occasion will depend on a number of factors, including the level of "technology" in the cultivar (eg its qualitative characteristics), topography, the particular farming practice undertaken (eg, different grasses are suited to cattle, sheep, deer and dairy farming), climate, irrigation requirements, insect and disease pressure, unseasonable supply and demand patterns, bio security considerations and the exchange rate. Cultivars that show strong agronomic performance to the end user will attract stronger sales regardless of the breeder or wholesaling company.

Vertical integration

21.19 The proposed merger will result in limited vertical integration in the seeds distribution to the extent that both PGG and Wrightson are engaged at the various functional levels of the market (from breeding through to retailing). However, this vertical integration is not competitively significant, as there is a significant degree of competition at each functional level.

21.20 In particular, breeders utilise all wholesale distribution networks available to them. By way of example, Wrightson and PGG seeds are sold through their own stores and reps, other branded and independent supply stores, and through numerous independent on-farm reps. Similarly, Wrightson and PGG both provide their marketing and distribution networks to international companies selling their cultivars here.

21.21 The major researchers and wholesalers are identified at paragraph 21.13 above, and there are numerous retailers (including, for example, PGG Farm Supplies, Combined Rural Traders, Kubala Seeds, Wrightson, Hodder & Taylor, Tod Seeds, Seeds & Cereals, RD1, and Farmlands).

22 Previous acquisitions

PGG

22.1 PGG has undertaken the following acquisitions in the last three years:

(a) the acquisition of Wards Horticulture Limited, of Roxburgh, in July 2002;

(b) the acquisition of Irrigation & Pumping Services Limited in February 2003. This entity now trades as PGG Irrigation and Pumping; and

(c) the acquisition of seed company, Agricom (New Zealand) Limited (a seeds researcher and distributor), on 1 July 2005.

Wrightson

22.2 Obviously, the Commission is fully familiar with Wrightson's acquisition of W&K, which was implemented earlier this year. Wrightson has not undertaken any other acquisitions relevant to the affected markets in the last three years.

Other relevant information

22.3 In addition, PGG and Wrightson entered into a joint venture, to form New Zealand Wool Handlers Limited, which started operation in May 2004. Again, the Commission is familiar with this operation, having investigated the venture in late 2004 (*Memorandum from Deborah Rogers to Fritha Mackay dated 15 October 2004).*

PARTS III, IV AND V: COMPETITION ANALYSIS

23 In order to simplify the Commission's analysis, the Applicants provide below consolidated information relating to Parts III, IV and V of the notice for each market identified in Part II.

24 LIVESTOCK TRADING SERVICES IN THE SOUTH ISLAND

Constraints on market power by existing competition

Existing competitors

24.1 The South Island livestock trading market is characterised by a high degree of existing competition, and the merged entity will continue to face significant competition from a variety of participants, post-merger.

Competing agents

24.2 All of the agents identified in ***Appendix H*** will continue to provide considerable competition, post-merger. By way of example, Peter Walsh has developed a very successful business across 4 provinces in the South Island. Walsh sells through Tekapo, Omarama, Hakutaramea and Temuka, as well as in the paddock.

Meat companies

24.3 PGG estimates that up to **[ ]**% of all stock sold in the South Island is procured directly by meat companies. As discussed above, meat companies provide strong competition for both store and prime stock in the South Island. Agents for Alliance, PPCS, AFFCO, Canterbury Meat Packers and Progressive (as well as smaller abattoirs and supermarkets) procure store stock in direct competition with stock and station agents to ensure their farmer suppliers have a steady supply of stock ready for the slaughter. These companies are so competitive that they will often take no margin for this service.

24.4 Indeed, the competition between agents and meat companies is so vigorous that commission rates for in paddock sales average about **[ ]**% across the South Island, **[ ]**.

Alternative sales channels

24.5 While individual buyers of stock may have a preference for a certain channel, they will readily switch depending on supply and demand, location of stock, proximity to saleyards and the impact of climatic conditions on the livestock market (both availability and price). Farmers have become sophisticated and price-sensitive purchasers of services, and will adopt whatever method of sale facilitates the best possible return for each unit of stock.

24.6 In addition, farmers often transact between themselves without agent assistance to avoid commission costs (although this saving has to be balanced against the risk of a non-payment). With the general market determining the "going rate per kg", it is relatively straight forward these days for both parties to agree on price and delivery terms.

24.7 Finally, while internet sales are still nascent, the web is becoming an increasingly significant listing channel for both store stock and prime stock. Fonterra, for example, runs both an online prime stock trading service (Prime.ex) and a store stock trading service (Live.ex). Prime.ex allows farmers to sell prime stock directly to selected meat processors (such as AFFCO) whilst Live.ex provides an online marketplace for farmers to buy and sell store stock directly with other farmers – thereby completely eliminating the agents as middleman. In its first 12 months, this online trading system saw more than 250,000 stock listed and 40,000 notified sales between farmers. Even farmers without internet access can utilise this service via the Live.ex operators who send reports by fax or mail. This is expected to be a significant sales channel in the future. Farmers are becoming increasingly technologically savvy, and are constrained only by the availability of broadband services.

Near and new entrants

24.8 The merged entity will continue to be constrained by the threat of expansion by existing stock and station firms operating in the North. For example, while it does not have an established network of South Island agents, Elders has small shareholdings in various saleyard-owning companies in the South Island, and has previously expressed its intent to establish a presence in others. **[ ]**.

24.9 Indeed, Elders could do so without difficulty by attracting agents from established operators. A significant characteristic of the livestock trading market is the ease with which agents can, and do, transfer between firms.

24.10 Agent departure is particularly common immediately following stock and station mergers. Wrightson's experience with the Dalgety merger was that a number of agents chose other options (including the formation of new independent companies, such as Gisborne Farmers, Egan Livestock, Morrison Livestock, KBR Livestock, L I Redshaw, Robert Russell Livestock, Manawatu Livestock, Property Brokers Livestock, Sowman Livestock, Wairarapa Livestock, Robbie Stuart Co, John Dickson Livestock and Livestock Enterprises*).*

24.11 Similarly, Peter Walsh (operating a team of 9 agents over 4 provinces, selling both through Temuka saleyards and in paddock) left PGG after its merger with Reid 4 years ago. South Stock was formed in a similar manner. And, more recently, several agents have switched to PGG following Wrightson's acquisition of W&K.

24.12 **[ ]**

Other Considerations

24.13 Ironically, the mobility of a firm's own agents also limits its ability to raise agency prices. For example, any rise in commissions would subject the agent to considerable criticism from the farmer. Agents would respond by either pressuring the firm to reduce its prices, or establishing themselves as independents, and simply undercut the stock and station firm's margin (in both cases preserving the core relationship with the farmer). This constant risk of defection provides a strong constraint on the margins charged by stock and station firms. In addition, sale yard commissions are widely published, providing a benchmark for other forms of sale.

Conditions of expansion by existing competitors

Access to saleyards

24.14 Unlike the North Island, ownership of saleyards in the South Island is dispersed, and generally held by farmer co-operatives. For new market entrants or independent agents, this makes gaining entry at a saleyard particularly easy. Moreover, commission rates are relatively static, and average at about **[ ]**% across the South Island. A chart detailing ownership of saleyards is attached at ***Appendix J***.

24.15 While the merger will result in the merged entity holding all of the shares at Canterbury Park, and Tinwald (and an increased share at Balclutha), that aggregation is competitively insignificant. Importantly, access to any of these saleyards would be granted, if required by an agent. By way of example, Rural Livestock Limited currently sells at Canterbury Park, and two independent agents sell through Tinwald. In addition, both of these yards are proximate to Temuka (the largest saleyard in the South Island) and Timaru.

Paddock sales

24.16 Of course, many agents facilitate stock transactions in the paddock alone. Barriers to expansions by existing agents selling in the paddock are virtually non-existent, with the only capital requirements being a car and mobile phone. The main (and only significant) criterion is forming the initial relationship with farmers. Obviously, existing agents have already established these relationships, which explains why they can – and often do – seamlessly establish their own private agency business.

Coordinated market power

24.17 There is minimal scope for collusion in the livestock trading services industry. Referring to the Commission's *Mergers & Acquisitions Guidelines*, the market has the following features:

(a) a high degree of competition will remain in the market, with fragmented participation;

(b) there is some degree of product differentiation between live weight yards, other saleyards, paddock sales and meat company procurement;

(c) the market is dynamic with movement away from traditional saleyard auction models towards other forms of selling;

(d) new entry can occur quickly, and on a large scale;

(e) there are a number of independent agents who operate as fringe competitors (particularly in respect of paddock and direct procurement but also as saleyard agents);

(f) neither firm is a maverick in either saleyards or the paddock;

(g) the demand for all intermediated services is price elastic;

(h) meat companies' previous procurement practices apart, there is no history of collusive conduct in the livestock trading services market. Traditionally, it has been highly competitive, with low margins; and

(i) both farmers and buyers are savvy and sophisticated, and have a degree of countervailing power (through paddock sales, direct sales and prime stock sales).

(j) whilst both PGG and Wrightson belong to a common industry body (the New Zealand Stock & Station Agents Association) along with other significant industry players (including Allied Farmers and Elders), this does not facilitate collusive behaviour. The Association meets only rarely to act on industry-wide concerns (such as regulatory issues and animal welfare), and is not used as an information sharing medium.

Constraints on Market Power by the conduct of farmers

24.18 As discussed above, a significant constraint on the merged entity's livestock operations is the ability of farmers supplying livestock to switch from saleyard sales to either paddock sales or direct sales between farmers without the services of an agent, or to direct procurement by meat companies for finishing stock. Farmers will engage in direct trades to avoid the cost of the agency commissions, although this saving has to be balanced against the risk of non-payment. Hence, such transactions often occur between parties who have established and trusted relationships. In most cases the price is negotiated on a "cents per kg" basis, with the general market determining the "going rate per kg", it is relatively straight forward for both prices to agree on a price and delivery terms.

24.19 In addition, any attempt to increase agency fees will be met with vociferous protest from farmers, which will damage the merged entity's brand and reputation generally. Livestock trading is only one element of the farmer/firm business relationship. Farmers are sophisticated and canny purchasers of services, and will not hesitate to vote with their feet in respect of all aspects of the merged entity's business.

Conclusion on Livestock Trading

24.20 Despite the proposed merger aggregating the market shares of PGG and Wrightson, the market will continue to be characterised by a high level of competitive pressure. Much of this pressure stems from the ability for farmers to utilise alternative sales channels in the face of increased agency prices. Agents can simply not afford farmers switching sales channel and therefore must remain price competitive with other modes of sale if they want to remain viable.

24.21 Additionally, the proposed merger will not lead to any substantial aggregation in saleyard ownership. Traditionally this has been the main area of competitive concern due to the perceived ability to exclude competitors from a major sales channel. Post-merger, all saleyards will continue to be available to other competitors.

24.22 Finally, existing competitors as well as new entrants will continue to constrain the merged entity. History has shown that industry mergers lead to a "bleeding" of agents to competing firms, and also result in agents of the merged entity establishing independent operations. This is made easier by the very low barriers to entry and expansion in the market for livestock trading services.

24.23 Accordingly, the proposed merger will not lead to a lessening of competition in the livestock trading services market.

25 WOOL TRADING SERVICES IN NEW ZEALAND

Existing Competitors

Wool brokers

25.1 The merged entity will continue to face stiff competition from wool brokers competing for sales at various wool auctions held throughout the country. Indeed, the Commission has recognised in both the W&K Report and the JV Report that the wool services industry is characterised by "vigorous competition".

25.2 The primary existing market participants are identified in ***Appendix L***. In addition, numerous (at least 70) independent merchants also operate in the market including (to name a few) Whangarei Wool Brokers, South Wool, Kurow Wools, Pukekohe Wood Ltd, Jackson Wools, Aoteroa Wools Ltd and Dunstan Wools Ltd.

Direct sales

25.3 Of even greater competitive significance are direct sales, which account for the majority of wool sold in the New Zealand market. In other words – as with livestock trading – wool agents compete against different modes of sale (including private treaty), not just other brokers. The table below shows that in the 2003/04 year, direct sales constituted **[ ]** of wool handled. Importantly, the direct sales figures here exclude wool that is contracted directly by the processors themselves.

(Clean Tonnes)	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Auction Sales	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
% of Total	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Direct sales	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
% of Total	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Total	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
%	**100%**	**100%**	**100%**	**100%**	**100%**

(Source: Tectra New Zealand)

25.4 By way of example, ***Appendix L*** shows that while the merged entity will account for **[ ]** of the **[ ]** bales sold by brokers in New Zealand (**[ ]**%), when bales acquired by merchants are taken into account the figure reduces to **[ ]**%. Significantly, these figures exclude all direct sales (and some export sales) which account for over **[ ]**% of the market, meaning the merged entity will account for less than **[ ]**% of the total New Zealand wool market.

Conditions of entry and expansion

25.5 As previously found by the Commission in *Decision 436*, entry and expansion barriers are very low in the (Merino) wool trading services market, noting the following conditions (also relevant to the broader wool trading services market):

(a) *Access to a wool auction facility*: access to a wool auction facility can be gained by paying an access fee, and this does not represent a barrier to expansion or entry;

(b) *Provision of auction and related services*: to provide auction services a broker must act as agent for a grower, prepare a catalogue, and carry out the various other services associated with conducting an auction. The Commission concluded this did not represent a barrier to expansion or entry.

(c) *Reputation*: a new entrant is likely to face the need to develop relationships and confidence with farmers and exporters. However, the Commission saw this as simply the commercial need to meet customer expectations and provide a competitive service. The Commission noted the necessary field staff and other personnel are readily available from within the rural services industry. The Commission did not see this as a barrier to expansion or entry.

25.6 The Applicants agree with this analysis, although consider that it applies to wool trading services generally. Existing competitors can readily expand operations through existing capacity. This could be achieved either through employing more field staff to procure direct sales or by offering to act as agent for more sales at auction. Existing competitors already have the necessary expertise to do this, and the incremental cost of increasing supply would be low.

25.7 Field staff in the rural services sector are highly mobile, and if a firm wishes to enter into (or expand its operations in) the wool trading services market, it will have no difficulty in accessing the necessary expertise. Primary Wool, for example, was formed by former employees following the Wrightson/Dalgety merger.

25.8 Because of these low barriers to entry and expansion, the merged entity will continue to face considerable constraint from the conduct of existing competitors, despite the increase in market concentration.

Coordinated market power

25.9 As with livestock trading, there is minimal scope for collusion in the wool trading services industry. Again referring to the Commission's *Mergers & Acquisitions Guidelines*:

(a) there is relatively high seller concentration in the market;

(b) there is no significant product differentiation with regards to wool trading services, although for "historical" reasons there is some amount of specialisation in merino wool;

(c) production technology is static;

(d) new entry can occur quickly;

(e) there are a number of fringe players in the industry;

(f) neither of the Applicants are maverick players in this industry;

(g) alternative sales channels ensures that demand is elastic;

(h) there is no history of collusion in the industry; and

(i) farmers are sophisticated operators who will change sales channel quickly in response to price increases, and buyers are also well informed about the price schedules and switch supplier in response to uncompetitive pricing.

25.10 While the Applicants belong to the New Zealand Wool Brokers Association (along with other competitors such as Primary Wool, Allied Farmers Wool and Southland Farmers Wool), the Applicants do not consider that this body facilitates coordinated behaviour.

Constraints on market power by the conduct of farmers

25.11 As noted in the JV Report, the ability of farmers to switch suppliers if they are dissatisfied with the prices or quality of service they are receiving is a major constraint. Accordingly, the merged entity will have to remain price competitive to ensure that supply continues.

Conclusion

25.12 The proposed merger will not lead to a lessening of competition in the wool trading services market. Although the merger will combine the market share of two significant players, the joint market share will still be relatively low due to most sales being made via the direct sales channel. In addition, low barriers to entry to the market plus the existence of smaller existing competitors will mean that the merger will not raise anticompetitive concerns.

26 REGIONAL MARKETS FOR THE RETAIL SUPPLY OF RURAL MERCHANDISE

Regions with aggregation

26.1 A map indicating the locations of the various rural and horticultural supplies stores belonging to each of the Applicants is attached at ***Appendix O***. Aggregation will occur in various towns, with the merged entity the only participants to have “full service” rural supplies stores in Amberley, Culverden, Fairlie, Geraldine, Kurow, Lawrence, Ranfurly and Otautau.

Constraints imposed by existing competition

26.2 The proposed merger involves the amalgamation of two significant branded rural merchandisers. However, the merged entity will continue to face strong competition from the following competitors post-merger:

(a) other full service independent rural and horticultural supplies stores located in the same or neighbouring towns. These suppliers use a variety of sophisticated sales channels including internet stores, telephone sales, catalogue retailers and crop selling through "on-farm" representatives and mobile account managers;

(b) independent rural and horticultural suppliers located in the same or neighbouring towns, such as Ashburton Trading Society (ATS);

(c) other providers of products exist in various categories including large discount retailers (for example, The Warehouse, Mitre 10 and Bunnings Warehouse), wholesalers and manufacturers of farm supplies (such as timber yards and fencing specialists);

(d) direct sales in respect of certain products (for example, Ravensdown sells fertiliser, animal health, agricultural chemicals and seeds direct to farmers, cutting out the rural supplies chain altogether); and

(e) a variety of specialist providers, such as veterinarians, who can bundle the sale of, say, drench and other products with the provision of animal health services. North Otago Vets (which operates throughout the South and North Islands) is a particularly good example of a small operator offering strong competition in respect of certain products.

26.3 Obviously the most significant existing competitors are the other large, full service rural supply stores, CRT and RD1. While such firms may not be present in every rural locality, the mobility of farmers has increased with better roads and modern vehicles. Farmers will now travel much greater distances than previously for a "good deal" and are able to purchase products by phone or internet from stores at a considerable distance.

26.4 Moreover, most providers have on-farm reps who come to the farmer's own gate. Importantly, success in rural supplies is reliant on good relationships with farmer customers. Accordingly, a small two-man operation can be a multi-million dollar business simply through effective reps making on-farm "drive-way" visits. Indeed, despite the Applicants' extensive range of stores throughout the South Island, only **[ ]**% of its rural supplies are sold through stores, with the remaining **[ ]**% sold "on farm".

26.5 Additionally, farmers are increasingly sourcing their supplies direct from the manufacturer, as was recently noted by John Lea, Chief Executive Officer of RD1:

> *[RD1] know that in some categories up to 30 per cent of [farmers] purchase core on-farm products straight from the manufacturer because [farmers] cannot get that choice or price from local farm supplies stores.* [3]

Barriers to expansion and entry

26.6 At paragraphs 68 and 72 of the RD1 Memorandum, the Commission noted in respect of rural merchandise that:

> *Industry participants advised that there are no real barriers to entry into this market… The barriers to entry are not likely to deter expansion or new entry in the rural merchandise market and potential competition is likely to provide constraint on the exercise of market power of the merged entity.*

26.7 The Commission also noted in the W&K Report that in the context of that investigation:

> *All industry participants spoken to…advised that, in their view, there are no barriers to entry or expansion in the affected markets. This information gathered indicates that the barriers to entry and expansion continue to be low.*

26.8 The Applicants agree with this conclusion. The cost of establishing a new store is certainly not prohibitive, and the merger (and subsequent rationalisation) will make entry easier, by creating an existing opportunity in many localities for a new entrant to move into.

26.9 But, it is not necessary to have a store to compete in this market now. As discussed above, the market for rural merchandise is characterised by strong competition from "on farm" reps. Such reps are very active in seeking out new customers, and can cover significant geographic areas. As with livestock reps, barriers to new reps are virtually non-existent (although supply reps do need to establish a line of supply). By way of example, the South Island is characterised by a number of small players operating multi-million dollar rural merchandise businesses from their garden sheds. These players could easily increase their coverage areas by hiring additional staff in response to a price rise by the merged entity.

26.10 Finally, growth in internet purchasers indicates that on-line sales are an increasingly popular method of acquiring rural supplies. Farmers are increasingly "wired", and as sophisticated purchasers will easily find the

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[3] "RD1 enjoys customer growth from new changes", Farmlink, June 2005, p. 15.

cheapest and most effective method of acquiring product. New and existing entrants (or existing competitors) could easily expand internet sales or catalogue sales at minimal cost.

26.11 In respect of fertiliser, the Commission noted at paragraph 73 of the RD1 Memorandum:

> *The above analysis applies equally to the fertiliser market. There appears to be no barriers to an existing competitor[s] expanding its fertiliser sales or for a new entrant to sell fertiliser and this is likely to happen if the merged entity increased its fertiliser prices.*

26.12 These observations also relate equally to other categories of rural and horticultural supplies (for example, animal health or agricultural chemicals). Indeed, Ravensdown currently supplies both of these product lines through direct marketing, and is considering expanding its current direct sales from fertiliser and agchem to others, such as fencing and seeds.

26.13 Nor are farmers particularly loyal to established brands. As recognised by the Commission at paragraph 46 of the RD1 Memorandum, farmers "have three or four accounts for rural merchandise and will shop at more than one store". Farmers often pre-check a price by calling before making a trip to town, and readily discriminate on price alone in respect of a particular product. In addition, new distribution channels are lowering transaction costs and creating greater price competition in the various product markets.

Coordinated market power

26.14 Again, there is minimal scope for collusion in the rural supplies market as:

(a) there is a very high degree of competition in the market, both between competing rural supplies stores and various retailers;

(b) there is some degree of differentiation between rural supplies stores, with expansion into different sales channels (including on-farm sales);

(c) there is movement away from traditional supply store chains towards more sophisticated forms of selling (including direct sales and internet sales);

(d) new entry can occur quickly, once supply of relevant product is obtained;

(e) there are a number of fringe players in each market;

(f) neither firm is a maverick in any of the markets;

(g) alternative distribution channels and new competitors make individual demand highly elastic;

(h) there is no history of collusive conduct in the industry; and

(i) farmers are savvy and sophisticated purchasers.

Conclusion

26.15 Far from lessening competition, the proposed merger will provide crucial rationalisation to an over serviced and relatively unprofitable rural and horticultural supplies market, benefiting not only market participants themselves but farmers and the entire New Zealand agricultural sector.

26.16 The merged entity will continue to face vigorous competition from existing full service stores such as RD1 and CRT, as well as from an array of smaller competitors ranging from veterinarians and hardware stores to mobile on-farm independents. In addition, the market for fertiliser will continue to be dominated by manufacturers selling direct to farmers.

27 THE RESEARCH AND DISTRIBUTION OF FORAGE SEED VARIETIES IN NEW ZEALAND

Introduction

27.1 Until the early 1980's, as few as 12 certified government bred cultivars were available to New Zealand pastoral farmers. These cultivars were referred to as "public cultivars", in that they did not generate a royalty return to the breeder. That description is still used today for non-proprietary cultivars.

27.2 Since then, private sector firms have been breeding improved forage and cereal cultivars, in return for a royalty to assist the funding of future plant breeding. There are no barriers to a firm entering that market. Those improved cultivars enjoyed rapid uptake by farmers, as they recognised the improved productivity that these cultivars delivered, which led to further plant breeding. Proprietary forage cultivars now comprise **[ ]**% of total annual usage.

27.3 The delivered value of improved cultivars, through the chain from research and breeding to on-farm performance, is now well accepted. Today's farmer wants a stronger relationship with science and is accepting that forage genetics of the future will have a stronger relationship with animal genetics than has been acknowledged in the past.

27.4 The emergence of novel endophytes (a fungus that avoids animal health problems such as stem weevil while maintaining positive effects on plant persistence, thereby reducing the need for fertilisers etc) provides a good example of the dynamic and fast moving nature of the market. Three years ago, the market for novel endophyte ryegrass was about 300 tonnes nationwide. Today, PGG estimates that over **[ ]**% of the hybrid and perennial seed sales comprise novel endophytes (**[ ]** tonnes). It has recently been reported that Dr Andy West (AgResearch's Chief Executive) is "adamant science and technology will deliver the next big productivity gains to the sheep meat industry, through parasite control [and] pasture enrichment ("more energy per mouthful")". Research and development of seeds is a vital part of that increased return for farmers.

27.5 New Zealand's reputation for pastoral science and its practical implementation brings its own risks, as international companies seek to capitalise on this too. Individually, local seed companies do not have the resources to maintain the level of investment required to ensure that the climatic and know-how advantages which New Zealand has, continue to be utilised principally for the benefit of New Zealand farmers rather than, potentially, their global competitors.

27.6 That said, some New Zealand seed companies have been able to expand into those global markets themselves to a limited degree. But unity will be required to gain critical mass to complete internationally. The northern hemisphere seed companies are expanding, and have already extended their operations throughout Europe, America, and Asia. They now are targeting Australasia. These companies have access to significant resources, and most have aggressive expansion plans. For New Zealand to maintain its leadership in this field will require a level of unity previously not recorded. If the proposed merger does not proceed, New Zealand farmers will quickly see their local seed companies being "picked off" by foreign interests which do not have the same affinity with the New Zealand agricultural sector as the Applicants do.

Existing competition

27.7 There are a number of existing competitors involved in the research and distribution of agricultural seeds in New Zealand. These breeders and wholesalers are identified in paragraph 21.13 above. In particular, the recent entry of both DLF and Germinal Holdings indicates the ease with which large companies can enter the market. In particular, Germinal Holdings has already produced 100 tonnes of product (within 12 months of entry), and is gaining market share quickly. It claims to have improved the characteristics of its grasses with higher sugar levels than New Zealand bred material, and has recently entered into discussions with AgResearch to add AR1 endophytes to its product line.

Direct imports

27.8 The merged entity will also be constrained by the ability of farmers and other wholesalers to import proprietary seed from overseas (under a licence arrangement) for multiplication and/or pastoral use.

27.9 The progeny of the multiplication is sent to a nominated destination or distributed on the New Zealand market. Some seed companies test seeds prior to committing to multiplication (as some species do not adapt to the New Zealand environment). Testing usually takes between one and three years. Examples of companies that utilise local firms for multiplication and distribution include RAGT Semences, Enforce Limagrain (both large French multinational seed breeders and distributors) and Jooland. In particular, the existence of a variety of wholesalers with established distribution networks makes entry by large international breeders very easy.

Countervailing power

27.10 The success of a seed depends heavily on the loyalty it enjoys with the farmer purchaser. As with other aspects of the rural services industry, trusting relationship between seed retailer and farmer is paramount. Importantly, seed choice only comprises 10-20% of the pasture management equation (which also includes fertiliser, ground preparation, weed control, stock cycles, irrigation etc). Wholesalers and other consultants provide detailed pasture management advice (often on-farm), thereby building a strong relationship of trust with the farmer. Both wholesalers and retailers will stop recommending a cultivar if they do not believe it is the best option for their customers, in terms of either performance or value for money.

27.11 Similarly, farmer purchasers will vote with their feet if a particular cultivar is overpriced or does not perform well.

Barriers to expansion or entry

General

27.12 There are very low barriers to expansion or entry for breeders and wholesalers of seeds. The Commission, when considering the market for wholesale distribution and retailing of grain and seeds in *Hodder & Tolley*, stated that:

> *There are no significant entry barriers for those planning to enter this market… Further, there are no impediments to prevent existing grain and seed merchants from expanding their market share, or for new firms to enter this market, or in relation to grain and non-proprietary seed varieties, for farmers to trade amongst themselves. (paras 32 and 33)*

27.13 In relation to the market for research and development services in seed technology, the Commission stated:

> *…there are no significant entry barriers into this market. For example, technical expertise is widely available, both within New Zealand and overseas. While there is a requirement to obtain sufficient funding to finance the development of new strains of seeds, and several years are needed to develop a new seed variety, we*

do not consider that these requirements represent insurmountable barriers. (para 45)

27.14 The Applicants agree with this assessment. In particular, the Applicants' own expansion was further developed following earlier success with marketing and developing selections of rape and kale. Four years ago PGG did not have a recognised brassica portfolio, but today has brand-leading cultivars following proven performance in the paddock. PGG's brassica expansion has also been possible by marketing a selection of Joorden's (a Dutch seeds firm) cultivars here.

Contracted research services

27.15 In terms of research and development, all market participants may contract AgResearch or Crop and Food Research (or other private research bodies) to undertake applied research and testing on new proprietary cultivars. There are also a number of international institutions which provide similar services to seed companies based here, such as AgriSeeds and Midlands Seed.

Regulatory barriers

27.16 There are no regulatory impediments to operating seed research or distribution activities in New Zealand.

27.17 The Plant Variety Rights Act 1987 ("*PVR Act*") governs the breeding and marketing of proprietary seeds, and provides for exclusive intellectual rights over the production of proprietary plant seed varieties covered by the PVR Act. After the expiration of three years of making a protective grant, the Commissioner of Plant Variety Rights may (on request) grant a compulsory licence for the reproduction and sale of the protected variety to the requestor, and order the grantee to sell that material at a reasonable price.

27.18 This legislation does not provide a barrier to entry to new entrants or existing competitors wanting to expand operations. The Commission agreed with this assessment in *Hodder & Tolley*, noting that the PVR Act did not provide "any significant impediments those wishing to enter into, or expand in the market" (para 46).

27.19 While there are some biosecurity requirements (for example, the quarantining of certain seed lines that have not previously been cleared for import), these do not amount to a barrier to expansion or entry.

Near and new entrants

27.20 New Zealand's location and conditions provide strong incentives for Northern hemisphere seed companies to expand operations to the Southern hemisphere. Establishing operations in New Zealand mitigates risks around seed multiplication and testing for Northern hemisphere based companies (the reverse is true of companies based in the Southern hemisphere), by reducing a 12 month production cycle to six months. It also helps currency and product risks, by running trials and multiplications in more than one geographic location (which might be afflicted by severe climatic conditions one year, etc).

27.21 Accordingly, there are a number of multinational seed organisations that are likely to enter the market in the short term, or could do so in response to a price increase by the merged entity (particularly those whose operations are based in countries with similar climatic conditions to New Zealand – such as Western Europe and Great Britain, parts of Australia, west South America and parts of North America).

27.22 For example, the DLF Group operates seed breeding and distribution operations across Europe and North America. RAGT has established relationships with a number of New Zealand organisations, including Stevens Seeds and Canterbury Seed, and is considered a likely entrant to the market in the short term. Similarly, RAGT Semences and DSB (both large multinational seed companies) could enter the New Zealand market with ease. As discussed above, RAGT Semences already has an established multiplication relationship here.

27.23 Closer to home, there are a number of Australian seed breeders and wholesalers that could easily enter the New Zealand market, including:

(a) Heritage (owned by Barenburg);

(b) Vic Seeds (cooperatively owned by Australian farmers);

(c) Valley Seeds;

(d) Seedmark;

(e) Plantech;

(f) Elders;

(g) Pacific Seeds; and

(h) Australian Wheat Board.

27.24 Some of these companies are already involved in plant breeding here on a minor scale, or have an association with a New Zealand based plant breeding programme. The Applicants consider that these Australian companies could establish a presence here very easily, as New Zealand companies have done in Australia. Both Wrightson and PGG have a strong presence in the Australian market. PGG originally distributed product via an arrangement with Valley Seeds. But it now operates independent distribution arrangements in Tasmania, Victoria, NWS and Western Australia – generating profitable revenues within its first two years of operation, increasing the availability of new cultivars into the market, and gaining significant market share from Wrightson and Heritage.

Conclusion

27.25 Post-merger, the market will continue to be characterised by strong competition. Whilst existing competitors will remain to provide constraint on the merged entity, the Applicants expect that increasingly strong competition will come from the large multinational seeds businesses. These entities can deploy significant resource and also have lower production costs than New Zealand firms. Barriers to entry or expansion are very low in this market. So long as prices make it worthwhile, foreign players can easily expand, either through imports, or by establishing a more significant presence here.

27.26 Far from the proposed merger giving rise to competition concerns, this merger is essential for the ongoing competitiveness and survival of a truly New Zealand seeds industry.

This Notice is given by Hugh Martyn, Chief Executive Officer of Pyne Gould Guinness Limited and Barry Brook, Chief Executive Officer of Wrightson Limited.

We hereby confirm that:

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

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

Dated this 5th day of July 2005

____

Hugh Martyn
I am Chief Executive Officer of Pyne Gould Guinness Limited and am duly authorised to make this application.

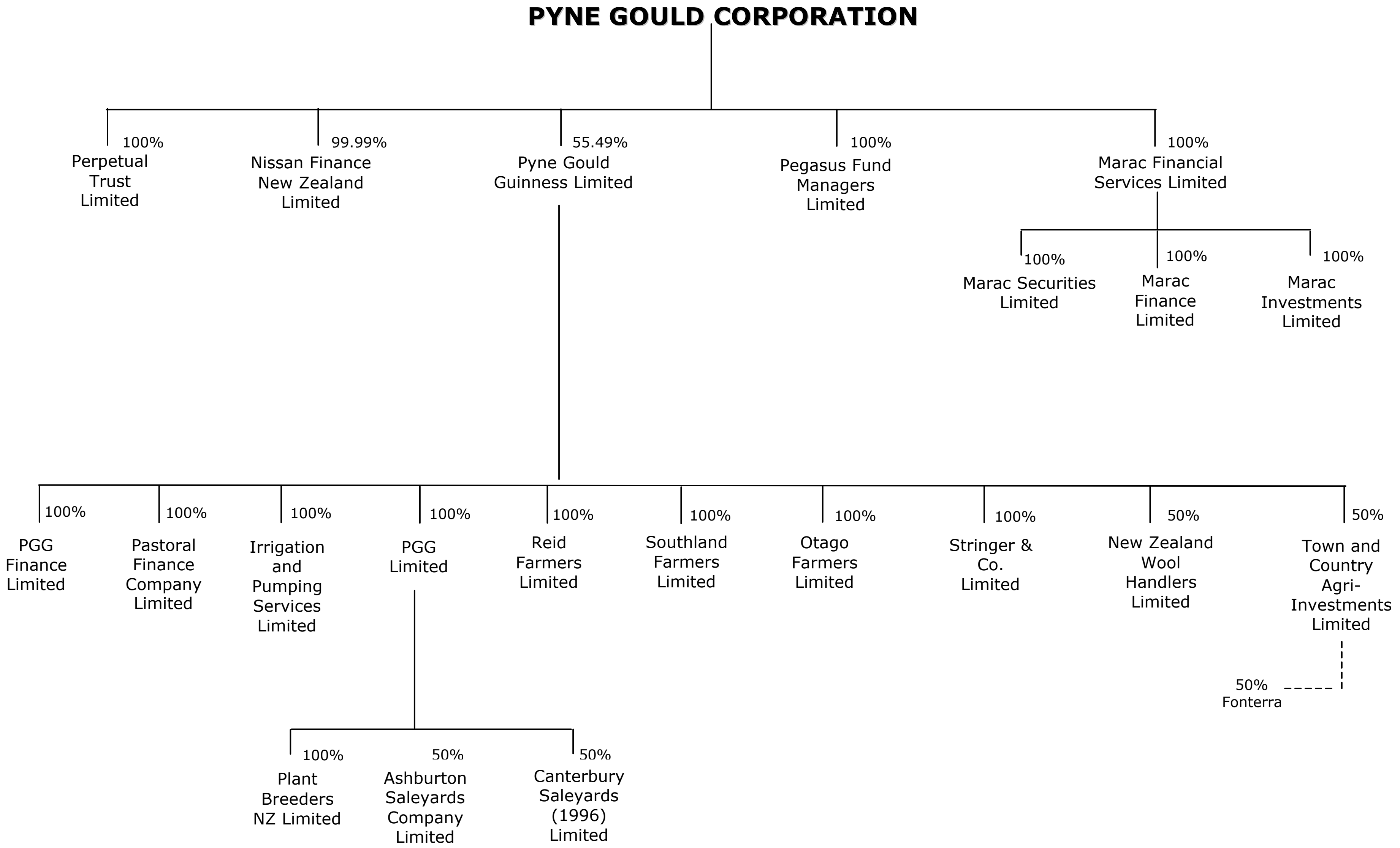
____

Barry Brook
I am Chief Executive Officer of Wrightson Limited and am duly authorised to make this application.

APPENDIX A: MERGER AGREEMENT AND SHAREHOLDERS' AGREEMENT

[ ]

APPENDIX B: PGC/PGG CORPORATE STRUCTURE DIAGRAM



APPENDIX C: PGC/PGG CORPORATE STRUCTURE

1 PGC has the following wholly owned subsidiaries:

1.1 Perpetual Trust Limited, a trustee and financial advice company;

1.2 Nissan Finance New Zealand Limited, a motor vehicle finance company providing wholesale finance and vehicle purchase finance to the Nissan dealer network;

1.3 Marac Financial Services Limited (*MFSL*), a finance company providing lending and investment products to businesses and individuals. MFSL also owns 100% of:

(a) Marac Securities Limited, a financial intermediary specialising in raising capital and debt;

(b) Marac Investments Limited;

(c) Marac Finance Limited, a finance company that provides finance, purchase and lease facilities for motor vehicles, commercial plant and equipment, marine and property; and

1.4 Pegasus Fund Managers Limited, a company that manages funds for Perpetual Trust Limited.

2 PGG, in turn, wholly owns the following subsidiaries in New Zealand:

2.1 PGG Limited (PGGL), which has the following subsidiaries:

(a) Plant Breeders NZ Limited (100%);

(b) Ashburton Saleyards Company Limited (50%); and

(c) Canterbury Saleyards (1996) Limited (50%);

2.2 PGG Finance Limited;

2.3 Pastoral Finance Company Limited;

2.4 Irrigation and Pumping Services Limited;

2.5 Reid Farmers Limited;

2.6 Southland Farmers Limited;

2.7 Otago Farmers Limited; and

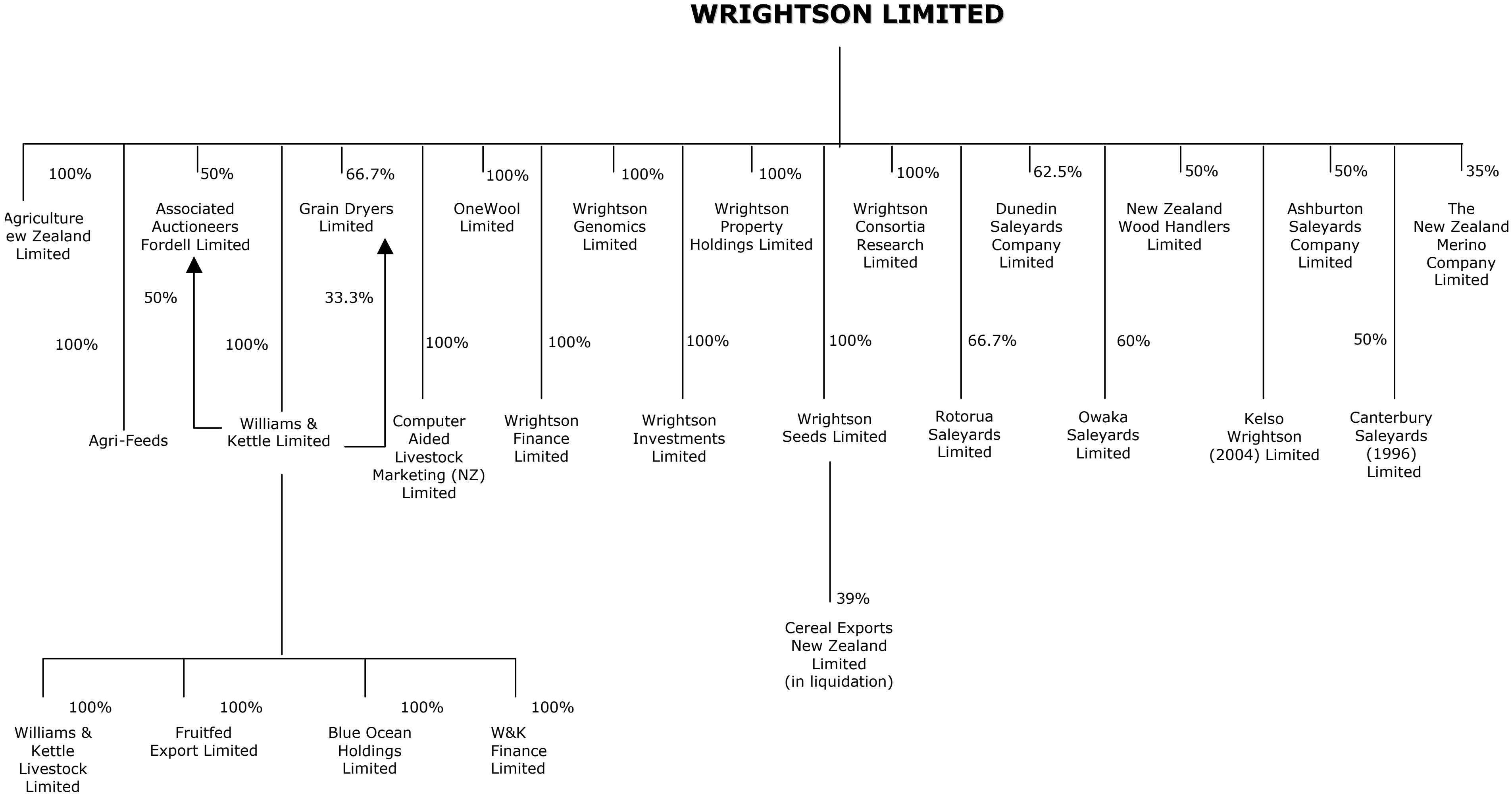
2.8 Stringer & Co Limited.

3 PGG also has interests in the following companies in New Zealand:

3.1 New Zealand Wool Handlers Limited (50%); and

3.2 Town and Country Agri-Investments Limited (50%) which is a 50:50 joint venture with Fonterra Co-operative Group Limited (Fonterra).

APPENDIX D: WRIGHTSON CORPORATE STRUCTURE DIAGRAM



APPENDIX E: WRIGHTSON CORPORATE STRUCTURE

1 Wrightson's New Zealand wholly-owned subsidiaries are:

1.1 Agriculture New Zealand Limited;

1.2 Agri-Feeds Limited;

1.3 Associated Auctioneers Fordell Limited (50% owned by Wrightson, and 50% owned by Williams and Kettle);

1.4 Computer Aided Livestock Marketing (NZ) Limited;

1.5 Grain Dryers Limited (66.7%, owned by Wrightson, and 33.3% owned by Williams and Kettle);

1.6 OneWool Limited;

1.7 Williams and Kettle Limited, which has four wholly owned subsidiaries:

(a) Williams & Kettle Livestock Limited;

(b) Fruitfed Export Limited;

(c) Blue Ocean Holdings Limited; and

(d) W & K Finance Limited;

1.8 Wrightson Finance Limited;

1.9 Wrightson Genomics Limited;

1.10 Wrightson Investments Limited;

1.11 Wrightson Property Holdings Limited;

1.12 Wrightson Seeds Limited; and

1.13 Wrightson Consortia Research Limited;

2 Wrightson also has the following New Zealand subsidiaries:

2.1 Rotorua Saleyards Limited (66.7%);

2.2 Kelso Wrightson (2004) Limited (50%);

2.3 Dunedin Saleyards Company Limited (62.5%)

2.4 Owaka Saleyards Limited (60%);

2.5 New Zealand Wool Handlers Limited (50%);

2.6 Ashburton Saleyards Company Limited (50%); and

2.7 Canterbury Saleyards (1996) Limited (50%).

APPENDIX F: FORMAL AND INFORMAL LINKS BETWEEN APPLICANTS

1 As far as the Applicants are aware, the only links formal or informal, between the Applicants or any interconnected persons in each market are through joint shareholdings between them are in the following companies:

1.1 New Zealand Wool Handlers Limited (*NZWHL*), a 50/50 joint venture company between Wrightson and PGG, was established in 2003 for the purpose of consolidating wool warehousing and handling operations;

3.3 Ashburton Saleyards Company Limited (50-50);

3.4 Canterbury Saleyards (1996) Limited (50-50);

3.5 Owaka Saleyards Limited (Wrightson 60%, PGG 40%);

3.6 Milton Saleyards Company Limited (Wrightson 46.3%, Reid Farmers (PGG) 23%);

3.7 Wool Exchange Invercargill Limited (Wrightson 40%, Reid Farmers (PGG) 20%);

3.8 Tarras Saleyards Company Limited (Wrightson 27.7%, PGG 3.5%);

3.9 Palmerston Saleyards (1961) Limited (Wrightson 27%, PGG 18%);

3.10 Balclutha Saleyards Company Limited (Wrightson 25%, PGG 12.5%);

3.11 West Otago Saleyards Company Limited (Wrightson 22.5%, PGG 21.4%);

3.12 Oamaru Farmers Saleyards Company Limited (Wrightson 23%, PGG 14.5%);

3.13 Omakau Cattle Saleyards Company Limited (Wrightson 21.2%, PGG 10.6%);

3.14 Rough Ridge Saleyards Company Limited (Wrightson 21.7%, PGG 6.2%);

3.15 Omarama Saleyards Company Limited (Wrightson 26%, PGG 5.5%);

3.16 Ashburton Realtor Limited (Wrightson 14.3%, PGG 14.3%);

3.17 Tapawera Saleyards Company Limited (Wrightson 7.4%, PGG 7.4%);

3.18 Castlerock Saleyards Limited (Wrightson 5.3%, Reid Farmers (PGG) 0.5%); and

3.19 Hawarden Saleyards 1953 Limited (Wrightson 1%, PGG 1%).

2 There are also links through joint ownership in the following companies that are currently subject to liquidation proceedings:

2.1 Cereal Exports New Zealand Limited (in liq.), of which Wrightson Seeds Limited owns 39%, and PGG 34%; and

2.2 Wool Exchange (Dunedin) Limited (in liq.), of which Wrightson owns 49% and PGG 26%.

3 The Applicants are also linked informally through membership of the New Zealand Stock & Station Agents Association.

APPENDIX G: CRA REPORT

CRA
INTERNATIONAL

FINAL REPORT - PUBLIC VERSION

Prepared For:

Chapman Tripp

1 - 13 Grey Street

Wellington, New Zealand

Merger of Pyne Gould Guinness and Wrightson

Prepared By:

James Mellsop
Elizabeth Pennie
With assistance from Professor Lewis Evans

CRA International

Level 27, PWC Tower

188 Quay Street, PO Box 2107

Auckland, New Zealand

Date: 5 July 2005

CRA Project No. D07447-00

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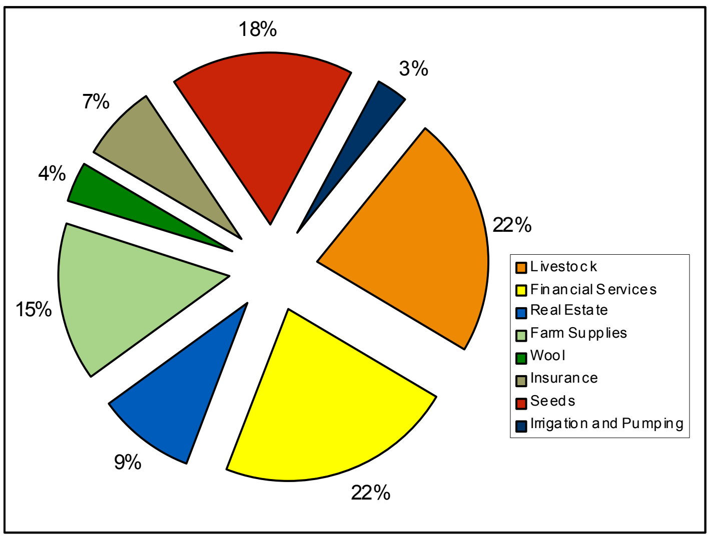
1. INTRODUCTION AND EXECUTIVE SUMMARY

1.1. INTRODUCTION

Pyne Gould Guinness Limited (PGG) and Wrightson Limited propose to merge. Both firms operate in what we might term the rural services industry – they provide goods and services to farmers.

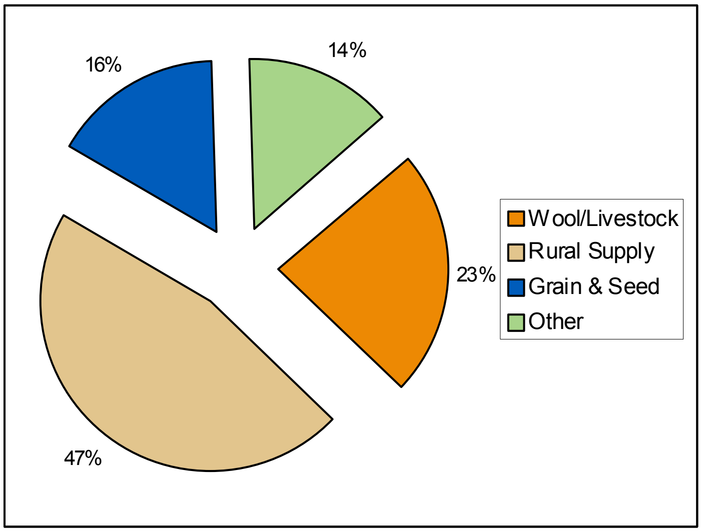
Both PGG and Wrightson are quite diversified across the rural servicing sector, as illustrated by Figure 1 and Figure 2.

Figure 1: PGG business divisions[1]



1 Figure based on 2004 Divisional Contribution Analysis", Annual Report 2004".

Figure 2: Wrightson business divisions[2]



The merger would result in material levels of aggregation in four particular areas: livestock trading, wool trading, retailing, and seeds.

It is important that the merger of PGG and Wrightson is assessed in the context of the changing dynamics of the New Zealand agricultural sector. Chapman Tripp, legal adviser to the merging parties, has asked us to analyse these changing dynamics, and their implications for the competitive and efficiency consequences of the merger.

Section 2 of this report describes the economic drivers of the rural servicing industry, and the changes in them. This section helps to explain the rationale for the merger. It also provides context for analysing the competition and efficiency implications of the merger, which are discussed in section 3 of this report.

1.2. EXECUTIVE SUMMARY

1.2.1. The Changing Dynamics of New Zealand Agriculture

It is important that the merger of PGG and Wrightson is assessed in the context of the changing dynamics of New Zealand agriculture:

- New Zealand farmers are being increasingly squeezed between more demanding world markets and higher input costs, especially land and technological inputs. In response, farms are becoming larger, fewer, more specialised and more productive.

2 Figure based on 2004 Sales Revenue, "Business Financial Analysis for Year Ended June", www.wrightson.co.nz.

- Rural servicing firms such as PGG and Wrightson are also being squeezed from both sides. Larger, fewer farms are more demanding. Entry, reduced transport costs and technology (such as the Internet) are increasing competitive pressures and undermining aspects of the traditional rural servicing business model.

- Driven by economies of scale in research and development (R&D), there has been a round of mergers among international seeds companies, and some of the world's largest seeds businesses have recently established beachheads in New Zealand.

These changes have important implications for the competitive effects of the proposed PGG/Wrightson merger.

1.2.2. Implications for PGG/Wrightson Merger

Livestock Trading Services

The livestock trading services market is at least as broad as the South Island, and includes:

- Yard and paddock sales; and

- Store and prime livestock sales.

The merged entity would be the single largest player in the South Island livestock trading services market, by quite a long way. Nevertheless, in our view the merged entity is unlikely to have the ability to unilaterally exercise market power, because of the large number of remaining competitors (including the meat companies) and the ease of expansion in this market. The industry is fluid, in the sense that agents switch brands frequently. Livestock trading, and rural servicing more generally, is a human resource business in which the quality of resource is important: the main loyalty of agents is to their farmer clients.

We also consider it unlikely that the merger will increase the prospects for collusion, because of:

- The large number of remaining players;

- The asymmetry in size between those remaining players, and the asymmetry in business models;

- The significant role played by the meat companies in the market; and

- The importance to individual agents of their relationships with farmers, as opposed to their employers, and the mobility of agents.

Wool Trading Services

The wool trading services market is at least as broad as the South Island, and includes:

- Broking and direct sales; and
- Merino broking.

The merged PGG/Wrightson entity will be the largest broker in the South Island wool trading services market. Nevertheless, in our view the merged entity is unlikely to have the ability to unilaterally exercise market power, because of the large number of remaining competitors (over seventy) and the ease of expansion in this market.

We also consider it unlikely that the merger will increase the prospects for collusion, because of:

- The large number of remaining players;
- The asymmetry in size between those remaining players, and the asymmetry in business models (e.g., broking versus direct sales); and
- The ease of expansion.

Rural Supplies

A variety of business models compete intensely in the rural supplies markets. The transaction cost rationale for the existence of one-stop rural retail stores is diminishing as transport costs drop and technology (e.g., the Internet) improves.

These pressures are contributing to the rationale for the proposed merger of PGG and Wrightson. Entry barriers are low and following the merger competitive pressures will continue to be strong.

Forage Seeds

The forage seeds market is dynamic, and competition takes place on innovation, characteristics and quality, as well as price.

It is probably most appropriate to analyse competition at the aggregate “forage seed” level.

We agree with the approach of the UK Office of Fair Trading in respect of its review of the Limagrain/Advanta merger[3], where it assessed the effects on competition by determining whether or not the merger reduced incentives to innovate or raised barriers to entry.

The merged PGG/Wrightson firm will have a large market share, but will continue to be pressured to innovate by existing competitors and large overseas entrants. Any barriers to entry (of which the Commission has previously found none to be significant) will be unaffected by the merger. Barriers to expansion are low.

3 “Completed acquisition by Limagrain of the Advanta European Seed Business”, June 2005, Office of Fair Trading.

2. THE CHANGING DYNAMICS OF NEW ZEALAND AGRICULTURE

2.1. INTRODUCTION

PGG and Wrightson operate in what we might term the rural services industry – these firms provide goods and services to farmers. Farmers and New Zealand citizens more generally have an interest in the rural services industry being productively and dynamically efficient.

In order to understand the rationale for the PGG/Wrightson merger, and the competition and efficiency implications, it is important to understand the economic drivers of the industry, and the changes in them.

2.2. THE CHANGING DYNAMICS OF NEW ZEALAND FARMING

2.2.1. Demand-Side Drivers

Because New Zealand agriculture is an export-oriented industry, it is sensitive to international prices. Recent shifts in the international economic environment have had a marked effect on the New Zealand agricultural industry.

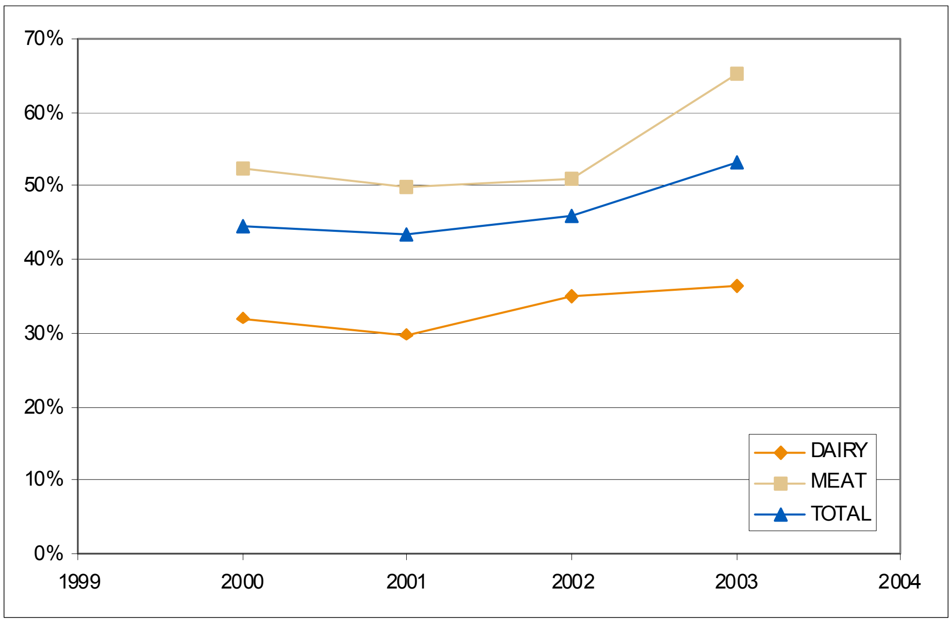
After very strong performance through the end of the 1990's, global agricultural commodity prices peaked in 2001 and then began falling, largely as a result of a weakening US dollar and a slowdown in both the US and the global economy (refer to Figure 4 below). In addition, in 2002 the New Zealand dollar began to strengthen against the US dollar, a trend that has continued ever since. This combination of weakening commodity prices and a strengthening New Zealand dollar has caused significant drops in New Zealand agricultural prices.[4]

In order for the New Zealand agricultural industry to continue to be profitable, it must respond to changes in international preferences and trends. These preferences have evolved significantly over the past decade, as international consumers have become more interested in what they eat, where it comes from, and how it is produced.

4 "2002 Post Election Brief", Ministry of Agriculture and Forestry, 2002.

One of the major changes in consumer food preferences is a move away from commodity products (e.g., carcases, milk powder) to value added products (e.g. packaged cuts and value added ingredients). Increasing levels of global urbanization, rising global incomes, and changing global lifestyles have been the major drivers behind this shift in preferences. Evidence of this change is reflected in the relative prices between these two types of products, and international output trends have responded accordingly.[5] This shift in output towards value added products is illustrated for New Zealand by Figure 3.

Figure 3: Value added exports as a percentage of total exports for meat, dairy, and total New Zealand agricultural exports[6]



5 "The State of Agricultural Commodity Markets 2004", Food and Agriculture Organization of the United Nations, 2004.

6 "A study into the level of value-added products in New Zealand ford and beverage exports", Massey University, 2004.

In addition to shifting their preferences towards value added products, modern consumers around the world are purchasing more and more of their foodstuffs from large supermarkets rather than from several smaller shops. There is evidence for this trend in the rapid growth of large supermarkets in both developed and developing countries. This change in consumer preference is having an effect on the agricultural industry: supermarkets prefer to buy their products from a smaller number of large international suppliers. As a result, a few large suppliers benefit, but the majority of smallholders are left out.[7]

A third major shift in consumer food preferences is consumers' relatively recent focus on how foodstuffs are produced. Not only are consumers concerned with the quality of the product, but they also differentiate between products based on factors like environmentally sustainable production, organic production, and levels of animal welfare.[8]

The shift away from commodity products and towards value added products has also had a major influence on the trend in wholesale buyers. Agricultural production chains are increasingly being dominated by large international trading, processing, and distribution companies. This is a relatively new development: for example, the number of coca traders in London shrank from 30 in 1980 to ten in 1999. This trend is evident across a wide range of foodstuffs. For example, three companies control 70-80 percent of the soybean crushing market in Europe and the United States, and three or four companies control 60-80 percent of the international grain trading, storage, processing, and milling market.[9]

The presence of large international firms has given rise to cooperation within may parts of the industry, yielding efficiency gains from product development, contract farming, and financial assistance. For some farmers, these changes have brought significant opportunities. However, smaller rural services businesses have often suffered:

> *"…. without assistance to improve their efficiency and competitiveness, many smallholders and domestic traders will struggle to meet the new market requirements."*[10]

There is evidence of this trend in New Zealand. The creation of Fonterra provides a good illustration. The reasons for the merger included a need to be more competitive in the international market place and the acknowledgement of an international trend towards consolidation in the global food retailer industry.[11]

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7 "The State of Agricultural Commodity Markets 2004", Food and Agriculture Organization of the United Nations, 2004.

8 "Contribution of the Land-based Primary Industries to New Zealand's Economic Growth", Ministry of Agriculture and Forestry, 2003.

9 "The State of Agricultural Commodity Markets 2004", Food and Agriculture Organization of the United Nations.

10 "The State of Agricultural Commodity Markets 2004", Food and Agriculture Organization of the United Nations.

11 www.fedfarm.org.nz

The dairy industry is not the only sector to experience significant consolidation. Similar mergers have taken place in the meat industry as well. The number of pig meat processors in New Zealand, for example, has halved over the past ten years.[12] PPCS has also recently purchased Richmond.

2.2.2. Supply-Side Drivers

In addition to international influences, the New Zealand agricultural industry is responding to domestic pressures as well. A significant domestic pressure has been a marked increase in the value of farmland – see Figure 4. One reason for this increase in value is the growing popularity of rural land for lifestyle purposes. The resulting general increase in the value of rural land has had a significant affect on farmers: more expensive land triggers increased start up costs,[13] and more generally means that an important cost input to farming is rising.

In order to continue to compete effectively in the international market, New Zealand agriculture has had to take advantage of the latest science and technology available in order to ensure its position as an international leader in efficiency of production.[14] In order for farmers to take advantage of the latest science and technology, the latest and most advanced farming inputs must be purchased. However, new, advanced inputs are expensive. In fact, studies note that around the world, farmers have become more and more heavily dependant on purchased inputs, and in recent years paying for these inputs has used up a significantly larger proportion of farm revenue.[15,16]

2.2.3. Implications for New Zealand Farming

The cumulative effect of international and domestic market developments has been that farmers are facing rising costs and either constant or decreasing returns, as illustrated in Figure 4.

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12 MAF website.

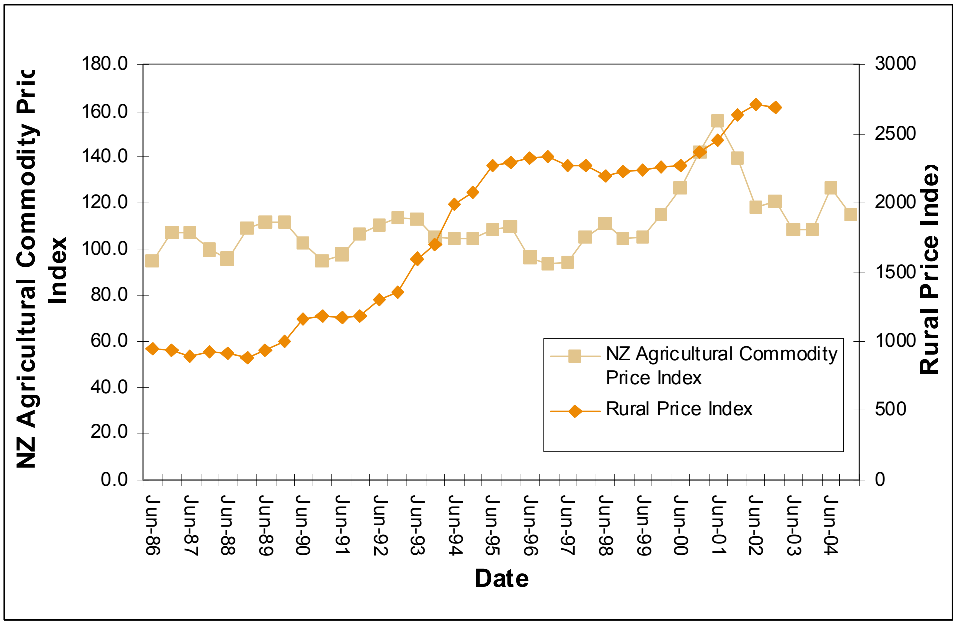
13 "Contribution of the Land-based Primary Industries to New Zealand's Economic Growth", Ministry of Agriculture and Forestry, 2003.

14 "2002 Post Election Brief", Ministry of Agriculture and Forestry, 2002.

15 "Structural Change in the Farm Inputs Industry", Rural Industries Research & Development Corporation, 1999.

16 Of course, another significant supply-side change occurred in the mid-1980s when farm subsidies were abolished. This has had an important impact on the number of sheep in New Zealand.

Figure 4: International agricultural commodity prices and New Zealand rural land prices[17]



Source: ANZ Bank and Quotable Value.

It is important to note that both of these indices are nominal. By using Quotable Value's Rural Price Index, the Reserve Bank's consumer price index, and ANZ Bank's New Zealand Agricultural Commodity Price Index, we have calculated real growth rates as well. The average annual real growth rate in the New Zealand agricultural commodity price index between June 1986 and June 2002 was –3.3 percent, while the average annual real growth rate in the rural price index between June 1986 and June 2002 was 2.4 percent. (For rural prices, the series we have actually goes back to 1980. The average annual real growth rate in the rural price index between June 1980 and June 2002 was 2.2 percent.)

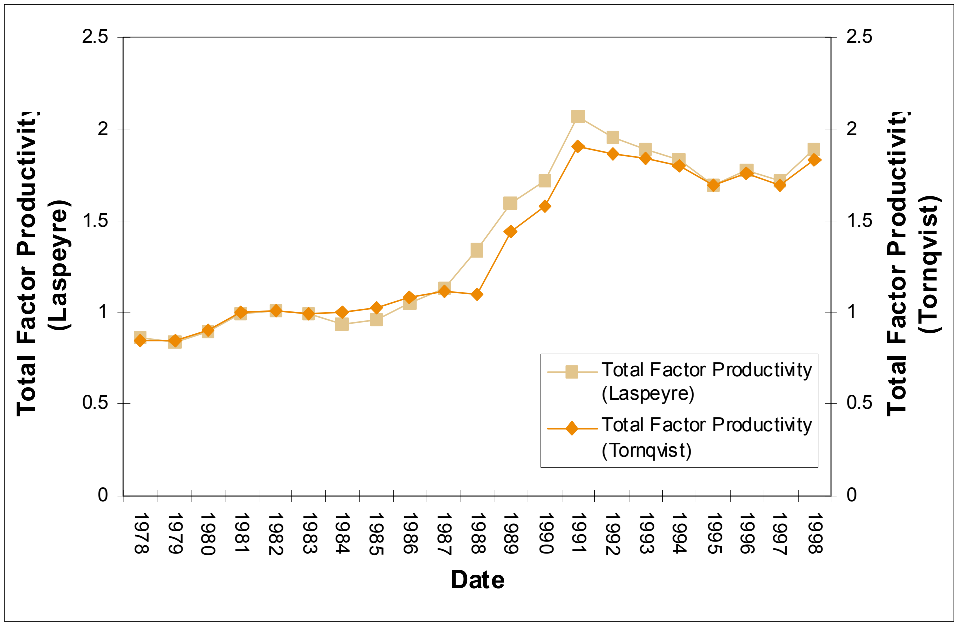
As a result of this situation, the New Zealand agricultural industry has had to respond aggressively in order to continue to be a profitable international enterprise. Responses have included effective targeting of investment, cost cutting and efficiency gains, achievement of scale economies through the expansion of the average size of farms, increased specialization within each type of farm and the adaptation of new technology - especially e-technology and biotechnology.[18]

These aggressive responses by farmers have been largely successful: productivity levels in the industry have risen consistently in recent history, as illustrated in Figure 5.

17 The international commodity price data is in New Zealand dollars.

18 "2002 Post Election Brief" Ministry of Agriculture and Forestry, 2002.

Figure 5: Total Factor Productivity Level in the Agricultural Industry



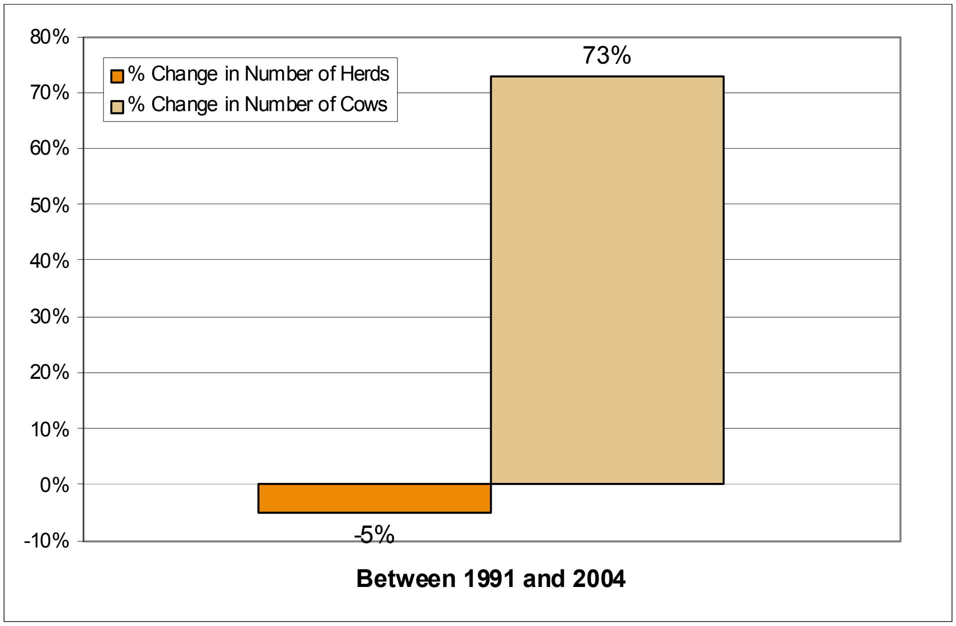
Source: MAF.

This increase in productivity is a result of several changes. One of the most noticeable changes that has occurred across the industry is increase in farm size. Although farm size is not included in the calculations of productivity shown in Figure 5, increasing farm size is cited as one of the factors that have made such increases in productivity possible.[19] It is noted that one of the major on-farm trends in the dairy industry, for example, is the consolidation and increase in both farm size and herd size, as well as the rise of corporate dairy farming.[20] This is confirmed by the Wrightson data illustrated in Figure 6.

19 “Recent Productivity Trends in New Zealand Primary Sectors, Agriculture Sector and Forestry & Logging Sector” Ministry of Agriculture and Forestry, 2000.

20 “Contribution of the Land-based Primary Industries to New Zealand’s Economic Growth”, Ministry of Agriculture and Forestry, 2003.

Figure 6: Changes in Number of Dairy Herds and Cows



Source: Data supplied by Wrightson.

There have also been significant changes in the use of farmland in response to changing trends in international demand. Many sheep and beef farms, for example, are being converted to horticulture and dairy farms. Another example of this is the evidence for increased amounts of crops such as grapes and avocados.[21] Another is the replacement of farming on hard hill country by trees: the average quality of land in farming has increased.

Another noticeable trend in the agricultural industry is the increasingly common use of biotechnology. In addition to biotechnology, there are a few other technologies, some digital, that are influencing the agricultural industry, including measuring and monitoring equipment and operations management.[22]

21 http://www.kiwicareers.govt.nz.

22 “Structural Change in the Farm Inputs Industry”, Rural Industries Research & Development Corporation, 1999.

2.3. DISRUPTIVE TECHNOLOGIES AND BUSINESS MODELS

2.3.1. The Internet

The arrival of the Internet has had an important effect on the agricultural industry not only in New Zealand, but also in developed countries around the world. It has enabled farmers, who traditionally have been limited by their remote location, to have better access to markets: both output markets where they sell their product and input markets where they purchase necessary supplies.[23]

The significant number of farms with Internet access shows that farmers are taking advantage of the resources offered by the Internet. Proportions of farms with Internet access in various countries is presented in Table 1.

Table 1: Percent of farms with Internet access in 2001[24]

Australia	34% (2000 figure)
United States	43%
New Zealand	60%

Source: Gregor, S., Rolfe, J., and D. Menzies (2002) "Influences on Engagement in E-Commerce in Agribusiness: An Empirical Study" ITiRA Conference, Rockhampton, 27-28 August 2002, 285-296; United States Department of Agriculture; Ministry of Agriculture and Forestry, New Zealand.

Farmers with Internet access use the Internet in a variety of different ways, ranging from communicating via email to online banking. The various ways in which New Zealand farmers use the Internet are summarised in Table 2.

Table 2: Specific types of Internet and computer use in New Zealand, 2002

Number of NZ farmers who use computers	83%
Number of NZ farmers who have access to email	79%
Number of NZ farmers who use the internet for online banking	36%
Number of NZ farmers who use the Internet to obtain farm related information	68%

Source: Federated Farmers, 2002.

23 Gabriele, F., "Internet Use and Farmers: How did the Internet Modify the Buying Habits in the Americas?" *Brandeis Graduate Journal,* v. 2, 2004.

24 None of the studies specified whether these figures represented broadband or dialup access. It is also important to note that this is not a portion of a complete time series data set, but is rather a collection of figures briefly mentioned in the text of the previously mentioned references.

The arrival of the Internet has triggered an important change in the nature of the relationship between farmers and rural servicing firms. This change has taken place as a result of the fact that the Internet and e-commerce help to:

- Reduce transaction costs;
- Produce direct cost reductions and quality improvements;
- Allocate resources better;
- Improve competitiveness;
- Increase availability of products; and
- Reach new markets.

For example,

> *"Now farmers who can access the Internet can search for those pesticides or other harvesting products online, track the cheapest price, and get products that are not available in their area."*[25]

As a result of the changes brought by the Internet and e-commerce, the traditional, regional relationships between farmers and rural services providers are breaking down as farmers have access to more market information and are able to compare the prices of and make purchases from many different suppliers in a much larger region.

2.3.2. Other Sales Channels and Business Models

Several alternative ways for farmers to obtain their inputs have recently emerged, making it unnecessary for farmers to do their business with traditional rural services firms, or at least altering the traditional mode of interaction. For example:

- [Confidential] percent of PGG's rural supplies sales are arranged via on-farm representatives, rather than via a farmer visiting a store.
- Ravensdown sells virtually all of its fertiliser product directly to farmers. Furthermore, Ravensdown now sells agri-chemicals through that same channel.[26]
- Vets and other retailers such as the Warehouse also sell rural supplies. For example, according to Wrightson data, vets now sell [Confidential]% of over the counter animal remedies.

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25 Gabriele, F., "Internet Use and Farmers: How did the Internet Modify the Buying Habits in the Americas?" *Brandeis Graduate Journal,* v. 2, 2004.

26 Grant Samuel (2004) "Independent Adviser's Report on The Partial Takeover Offer from Rural Portfolio Investments Limited".

- We are advised by Wrightson that two out of four manufacturers of conventional fencing sell direct to farmers.

These issues are discussed further in section 3.4 of this report.

2.4. Implications for Rural Servicing Firms

Rural servicing firms such as PGG and Wrightson are being squeezed from both sides. On the demand side, farms are becoming fewer, larger and more demanding. On the supply-side, entry and technology (such as the Internet) are increasing competitive pressures and undermining aspects of the traditional rural servicing business model.

The significant changes that have taken place in the agricultural industry are forcing the rural services industry to evolve,[27] particularly in the rural supplies and seeds businesses.

The traditional rural services industry business model called for each company to have numerous small retail outlets, each of which served a remote and relatively small geographic area. Farmers' current ability to purchase goods on the Internet or via other direct sales avenues, however, has reduced the need for many small retail outlets. Because of their access to the Internet, farmers are able to purchase inputs anywhere in the country or even the world, and simply have the goods shipped directly to the farm.

The advent of the Internet has also given farmers access to information allowing them to compare the prices of goods from several different companies. This has increased competition among rural services firms. This is in contrast to the traditional market environment, where rural isolation and markets limited by geographical area limited competition.

As a result of increased competition, economies of scale have also become a significant factor for rural servicing firms. A few large rural services retail centres are able to fill farmers' online orders and take advantage of economies of scale, making them more efficient than lots of smaller, relatively remote centres.[28]

In respect of seeds, as discussed in section 3.5 of this report, some of the world's largest seeds companies have recently established beachheads in New Zealand, and represent a significant competitive threat to New Zealand players. Competition in the seeds business is driven by R&D, for which there are important economies of scale.

27 "Structural Change in the Farm Inputs Industry", Rural Industries Research & Development Corporation, 1999.

28 "Structural Change in the Farm Inputs Industry", Rural Industries Research & Development Corporation, 1999.

Finally, changes in the agricultural sector triggered by the arrival of the Internet have provided another way in which farmers can sell their output. There are Internet sites, for example, where farmers can sell wool, livestock and grain directly to bidders, entirely skipping the middleman role traditionally filled by rural services industries.[29]

2.5. International Trends

Like farms, rural services industries have also been going though a period of consolidation. There is evidence for this trend around the world. In the 1990s, for example, the rural services industry in Australia underwent a well-documented period of consolidation. Researchers note that more than 15 companies in the Australian rural services industry were taken over or merged between 1993 and 1999.[30]

Researchers also predict that within the rural services industry, manufacturers of farm inputs (firms that make tractors, etc) will merge into fewer, larger companies. Change in industry structure will be driven by several factors, including the high cost of research and development, the economics of manufacturing and distribution, and mature domestic markets. Not only is the consolidation of farm inputs firms predicted to continue, but the importance of farm inputs is expected to increase in significance, due to increased farm specialization.[31]

This trend of consolidation and rationalization of the farm inputs sector is also expected to extend to the Australian merchandise market. Researchers report:

> *"Rationalisation in the rural merchandise market has reduced the number of retail outlets in smaller country towns."*[32]

The study also notes the effects of this trend, saying that where small rural merchandising operations have been replaced with larger, chain operations, farmers have benefited through the increased range of production inputs offered.[33]

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29 Gabriele, F., "Internet Use and Farmers: How did the Internet Modify the Buying Habits in the Americas?" *Brandeis Graduate Journal,* v. 2, 2004.

30 Heilbron, S., and F. Roberts (1999) "Structural Change in the Farm Inputs Industry" Rural Industries Research and Development Corporation.

31 Heilbron, S., and F. Roberts (1999) "Structural Change in the Farm Inputs Industry" Rural Industries Research and Development Corporation.

32 Heilbron, S., and F. Roberts (1999) "Structural Change in the Farm Inputs Industry" Rural Industries Research and Development Corporation, p. 96.

33 Heilbron, S., and F. Roberts (1999) "Structural Change in the Farm Inputs Industry" Rural Industries Research and Development Corporation, p. 96.

There is widespread evidence for this trend of consolidation and rationalization in the US as well: the 1990s saw record numbers of mergers across all areas of the country, and affected all types of agribusiness. The consolidation started in the poultry and pork portions of the industry, where the focus was shifting from “commodity marketing” to “product delivery”. From this beginning, the mergers trend spread to dairy, and finally to the grains portion of the agribusiness industry.[34]

Not only did the consolidation trend affect all areas of the agribusiness industry, but it affected all types of firms and included all types of mergers as well. In the US, agribusinesses are usually structured in one of two ways. They are either farmer owned cooperatives (e.g., Land O’Lakes) or investor-owned firms (e.g., Archer-Daniels-Midland). The consolidation trend is evident regardless of the type of firm.[35]

A combination of national and international forces drove this industry restructuring. Agribusiness firms were merging for several reasons, including a general tightening of the supply chain in order to take advantage of economies of scale, to gain a critical mass, to build market share, to more effectively use capacity, and to take advantage of vertical integration.[36] Domestically, this consolidation became necessary as a result of sagging prices for agricultural goods and an increase in the relative market power of the food-retailing sector. Widespread consolidation also became necessary in order to compete in a very competitive global economy, and to try and counter the increasingly weak US agricultural exports.[37]

Like many other segments of the agricultural industry, the international seed industry has also undergone significant consolidation. In the US, for example, the last three decades have seen significant transition to a few large international firms.[38] In the 1970’s more than 50 seed companies were acquired by pharmaceutical, petrochemical, and food firms that possessed the resources required to take advantage of economies of scale in research and development. Early breakthroughs in biotechnology prompted an additional wave of mergers in the 1980’s in order to offset the significantly increased costs of research and development. This trend has continued through the 1990’s.

34 Crooks, Anthony (2000) “Consolidation in the Heartland: A closer look at grain co-op mergers and acquisitions, 1993-97” USDA Rural Development.

35 Merlo, C ed. (1998) “When Cooperatives Combine: The merger boom is reshaping the look – and the future – of America’s rural co-ops” *Rural Cooperatives,* pp. 18-23.

36 Wasdsworth, James (1999) “Large cooperatives unifying: A strategic trend to monitor” USDA Rural Development.

37 Crooks, Anthony (2000) “Consolidation in the Heartland: A closer look at grain co-op mergers and acquisitions, 1993-97” USDA Rural Development.

38 “Seed Industry Struture Is Characterized by Growth and Consolidation”, February, 2004, USDA.

This trend towards consolidation is evident in Europe as well. The business strategy of DLF-Trifolium, one of the larger European seed companies, is a good illustration. Starting in the 1990's the company began to expand significantly through a series of mergers. According to their chairman, DLF-Trifolium would like to continue this trend in order to stabilise markets and avoid duplicate research and development activities.[39]

39 "SMEs in the Danish Agrochemicals, Seeds and Pland Biotechnology Industries", November 2000, European Commission.

3. IMPLICATIONS FOR PGG/WRIGHTSON MERGER

3.1. INTRODUCTION

In this section, we analyse the effects of the merger in the context of the above discussion.

3.2. LIVESTOCK TRADING SERVICES

3.2.1. Market Definition

We have previously analysed livestock trading services market definition in the context of the acquisition by Wrightson of Williams & Kettle.[40]

Saleyards Versus Paddocks

There are essentially two types of intermediary services offered:

- Auctions at a saleyard; and
- Sales in the paddock (which may themselves be auctions).

In its 1996 Investigation Report,[41] the Commission found that yard sales and paddock sales fell within the same market. The Commission was particularly impressed that 50 percent of store stock was sold in the paddock.

In the Wrightson/W&K report, Commission staff felt that they did not need to form a view on whether or not yard and paddock sales compete.

Figure 7 shows total Wrightson South Island livestock trade tallies for dairy, beef, sheep and dairy beef. These totals are divided into auctions (being store and prime sales through saleyards), private (being store and prime through private sale and "on farm" auctions), and prime sales to meat companies. [Confidential]

[Confidential]

Figure 7: Wrightson Dairy, Beef, Sheep and Dairy Beef Tallies in the South Island – Total, Prime, Private and Auction

[Confidential]

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40 See memo by James Mellsop and Michael Wilkinson to Grant David, dated 17 February 2005 and entitled "Wrightson/Williams & Kettle – Market Definition".

41 Commerce Commission (1996) *Investigation Report: Access to Saleyards*, Assessment of Complaint Against Wrightson and JF Jones.

Source: Data supplied by Wrightson.

We have also received data from PGG. PGG record sales in which it is involved as either "auction", "paddock" or "direct to slaughter". However, we understand that the "auction" and "paddock" categories include some prime stock.

The PGG data is set out in Table 3.

Table 3: PGG Livestock Sales by Method of Sale

[Confidential]

Yard sales and paddocks sales are simply different methods of sale. If one method was clearly superior to the other, we would expect to see the superior mechanism dominate the market. There is no strong evidence that one or the other method is doing this, [Confidential].[42] A farmer will choose whatever mechanism he believes will maximise his profit, presumably trading-off the potentially higher prices achievable from a competitive yard auction with the production and transaction costs of participating in such an auction.[43] It is quite possible that a farmer's preference will change over time, depending on economic cycles, the evolution of information exchange methods, etc.[44] Furthermore, we might expect farmers to be quite price sensitive, given the importance of livestock revenue to their business.

The evidence illustrated in Figure 7 is exactly the type of evidence accepted by the High Court in *Brambles* as being indicative of differentiated products competing: here the product is the process relating to the form of price discovery.

In its Wrightson/W&K report, the Commission states that:

> *There is no apparent correlation between the fees and the proximity of alternative saleyards, or even the sophistication of the facilities they have to offer.*

This is interesting, and implies that the constraint on saleyards' pricing comes from something other than other saleyards – paddock sales being the obvious explanation. We have seen no evidence to suggest that there is any correlation between fees and the proximity of alternative saleyards in the South Island, either.

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42 We also note that at a more disaggregated level in the Wrightson data, dairy livestock tend to be sold in the paddock ([Confidential] percent over the period 1996 to 2004).

43 Another benefit of a yard sale is the price discovery facilitated by a competitive auction.

44 For example, PGG explains the higher paddock sales in 2003/04 (see Table 3) as being due to farmers switching to this method in drought conditions. PGG expects improved feed conditions in 2004/05 to result in a shift back.

Store Versus Prime

The second issue is whether or not the market should be delineated by livestock type, particularly prime versus store stock.[45] This would be appropriate if the competitive dynamics differed depending upon livestock type. The Commission has previously made this delineation (in its 1996 Investigation Report) on the basis that prime stock was sold directly to the meat companies. However, in the Wrightson/W&K report, the Commission staff moved away from this, and found that the market includes both store stock and prime stock, noting that (paragraph 57):

> *However, since 1996 prime stock has become a key component of livestock trading and increasing amounts of prime stock are being sold through saleyards.*

In our view, the Commission staff's finding in the Wrightson/W&K report is correct. As we noted in our memo on the Wrightson/W&K merger, if a hypothetical supplier of store stock trading services attempted to impose a SSNIP, the meat companies could "switch production" into the provision of these services very easily and without incurring any material sunk costs. The meat companies already employ agents/buyers with local networks. Indeed, we understand from PGG that the South Island meat companies (e.g., Alliance, PPCS, AFFCO subsidiary South Pacific Meats, and Canterbury Meat Packers) already provide store stock livestock trading services.

The substantial degree of supply-side substitutability between store stock and prime stock trading services is demonstrated by the fact that PGG and Wrightson agents (and others) are active in providing both services in the South Island.[46]

Geographic Dimension

In the Wrightson/W&K report, the Commission staff adopted a North Island geographic market. The staff's rationale appears to be the ease of movement and expansion for livestock agents. We agree with this rationale – as we stated in our memo on the Wrightson/W&K merger:

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45 In its previous decisions on the meat industry, the Commission has split the livestock market into two (see decision numbers 273, 316, 371 and 441): the market for the procurement of sheep and lambs for slaughter and processing; and the market for the procurement of beef for slaughter and processing. As far as we are aware, this split is not relevant for present purposes.

46 In many cases (depending on the weather), store versus prime is a matter of timing (options to go to prime) based on expectations of feed prices, etc.

> *The other compelling argument for the geographic market being at least as wide as the North Island is the ease of supply-side substitution between regions. Suppose there was a hypothetical monopoly supplier of livestock trading services in the Hawkes Bay, and that that supplier attempted to impose a SSNIP. From the information that we have received, it would seem likely that such a price increase would be undermined by another livestock trading services supplier expanding its business from another region of the North Island (or even the South Island). We understand that no material sunk costs would be incurred in respect of such an expansion. Rather, all that would be needed is for the expanding firm to employ local agents, equip them with a car and cellphone, etc.*

In that memo we noted examples of North Island agents switching brands. We understand from PGG that there is plenty of evidence that South Island agents will switch brands as well. For example:

- At the time of the PGG/Reid merger (just over three years ago), Peter Walsh left and now has a team of 9 agents operating over four provinces in the South Island. Walsh sells through Tekapo, Omarama, Hakataramea and Temuka, as well as in the paddock.

- Southwest Livestock, based in Gore, has 8 to 10 agents throughout the West Coast and Otago. Southwest Livestock also formed out of the PGG/Reid merger.

- Rural Livestock, based in Christchurch, has 14 agents. Rural Livestock was formed out of the Wrightson/Dalgety merger.

Further examples are set out in section 3.2.2 below.

A result of these processes would be correlations between the average commission rates for agents in different regions. Such correlations appear to be observed in Figure 8 and Figure 9 below.

Figure 8: Average Commission Rates for Sheep Sales for Wrightson Agents at Five Largest SI Saleyards, 1999-2004

[Confidential]

Source: Data supplied by Wrightson.

Figure 9: Average Commission Rates for Cattle Sales for Wrightson Agents at Five Largest SI Saleyards, 1999-2004[47]

[Confidential]

47 Cattle sales commissions are the average of average beef cattle, average dairy cattle, and average dairy beef values.

Source: Data supplied by Wrightson.

3.2.2. Existing Competition

Market Shares

Figure 10 summarises the market share data that we have received from Wrightson.

Figure 10: Market Share in the South Island by number of agents, number of cattle, and number of sheep

[Confidential]

Source: Data supplied by Wrightson.

Unilateral Effects

The merged entity would be the single largest player in the South Island livestock trading services market, by quite a long way. Nevertheless, in our view the merged entity is unlikely to have the ability to unilaterally exercise market power, because of the large number of remaining competitors and the ease of expansion in this market.[48]

We discussed the ease of expansion in our Wrightson/W&K memo. We understand that no material sunk costs would be incurred in respect of expansion. Rather, all that would be needed is for the expanding firm to employ local agents, equip them with a car and cellphone, etc. As well as the South Island examples provided by PGG (as described in section 3.2.1 above), we understand from Wrightson that there is plenty of evidence that agents will switch brands. For example:

- In 1995, Allied Farmers, which had been based in Taranaki, expanded into the Waikato and King Country by employing agents formerly employed by the Elders units acquired by John F Jones Limited.
- Williams & Kettle was also a regional operator, based on the east coast from Gisborne to Masterton and in the Manawatu / Wanganui region until it acquired:
    - Leigh and Associates, a Kaikohe based company, with 9 livestock agents, a 1/3 share of the Kaikohe saleyard and 100% ownership of the Matakohe saleyards; and
    - Livestock Enterprises, which was an established livestock business based in the Waikato with 25 agents.

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48 The Commission's merger acquisition guidelines state that " … non-coordinated effects that can arise in oligopoly markets in which there are small numbers of fairly evenly-matched businesses" (page 32). That requirement clearly does not apply to the present circumstances.

Alternatively, agents employed by a hypothetical monopoly supplier might react to that supplier imposing a SSNIP by becoming independent or setting up their own firms in order to protect their individual reputations amongst farmers. PGG has provided us with specific South Island examples:

- Stapleton Livestock was formed by five ex-Wrightson Canterbury agents in 2000. The business was successful, and was purchased by PGG in 2003.

- Subsequent to the PGG/Reid Farmers merger, nine PGG Canterbury agents left and formed Peter Walsh and Associates. Over a three-year period, this business has grown and now has a 30 percent share of the weekly Temuka sales.

Livestock trading, and rural servicing more generally, is a human resource business in which the quality of resource is important: the main loyalty of agents is to their farmer clients.[49]

Coordinated Effects

We also consider it unlikely that the merger will increase the prospects for collusion, because of:

- The ease of entry (discussed below);

- The large number of remaining players;

- The asymmetry in size between those remaining players, and the asymmetry in business models;

- The significant role played by the meat companies in the market; and

- The importance to individual agents of their relationships with farmers, as opposed to their employers, and the mobility of agents.

3.2.3. Potential Competition

We have already discussed the ease of expansion within the livestock trading services market. It is difficult to identify any barriers that a new entrant into the market would face. Even branding does not seem to be an issue, as evidenced by the large number of independent agents operating, and the examples of expansion and entry given earlier in this report.

49 We have been advised by PGG that a good agent will take 80 percent of his business with him when he leaves a firm.

3.3. Wool Trading Services

3.3.1. Market Definition

Auction Versus Direct Sales

In its investigation into the formation of the New Zealand Wool Handlers Limited joint venture (15 October 2004), Commission staff found that (paragraph 31):

> *… considering the high demand-side and supply-side substitution, the Commission concludes that wool brokers, merchants, exporters and direct buyers compete in the same market, that being the market for wool.*

We agree with this conclusion. The data in Table 4 supports the Commission's demand-side substitutability analysis. This presents nation-wide data. We are advised by PGG that while private sales in the North Island might be slightly higher in the earlier years in Table 4, the 2002/03 figures would be applicable across the whole country.

Table 4: Wool Sales by Selling System (percentages)

[Confidential]

Source: Statistical Handbook compiled by Tectra Ltd.

Auctions and direct sales are simply different methods of sale. If one method was clearly superior to the other, we would expect to see the superior mechanism dominate the market. Yet there is no evidence that one or the other method is doing this. A farmer will choose whatever mechanism he believes will maximise his profit, and it is likely that a farmer's preference will change over time.

It is also important to note that wool farmers are not captive to selling at a particular time; rather, they have the option of storing their wool until the price rises. We understand from PGG that, due to the combination of falling commodity prices and the rising dollar, farmers are tending to hold their clip this year, hoping that prices improve next year.[50]

We understand that the proportions of Merino wool sold via auction and private sale do differ significantly from the proportions set out in Table 4. We are advised by PGG that [Confidential] percent of Merino wool is sold via auction. We next consider whether Merino wool trading services should be carved out from the more general wool trading market.

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50 A similar comment is attributed to the chairman of Allied Farmers by Marta Steeman of The Dominion, 30 June 2005 (www.stuff.co.nz).

Wool Grade

The Commission has previously carved out a merino fibre market from the broader wool market. This may well be reasonable. But it is important to note that this does not necessarily imply that the wool *trading* market should be similarly delineated.

Suppose for the moment that the market is limited to auction services. If a hypothetical monopoly supplier of auction services for Merino wool imposed a SSNIP, could a coarser fibre wool broker switch into Merino wool?

We are not aware of any barriers to such expansion. The process for auctioning Merino wool is essentially the same as that involved for auctioning coarser wool. It is our understanding that there are no specialist skills or physical capital required in order to broker Merino wool transactions beyond those required for other wool transactions.

Consider a livestock analogy. A sheep and a dairy cow are not substitutes in terms of end use. Yet no one has claimed that there is a division in the livestock trading services market based on type of animal.

The ease of expansion into the provision of Merino broking services is illustrated by the development of Southland Wool Brokers. We are advised by PGG that Southland Wool Brokers, traditionally a Southland coarse wool broker, expanded into Merino in the Canterbury region 4 years ago.

Geographic Dimension

There is only one wool auction location in the South Island, which is in Christchurch. There are storage facilities located around the South Island, and these are not specific assets. However, all that is required to be transported to the Christchurch auction site is a sample of the wool.

On the supply side, the argument for the geographic market being at least as wide as the South Island is the ease of supply-side substitution between regions. Suppose there was a hypothetical monopoly supplier of wool trading services in Canterbury, and that that supplier attempted to impose a SSNIP. From the information that we have received, it would seem likely that such a price increase would be undermined by another wool trading services supplier expanding its business from another region of the South Island (or even the North Island). We understand that no material sunk costs would be incurred in respect of such an expansion. Rather, all that would be needed is for the expanding firm to employ local agents, equip them with a car and cellphone, etc.

The Southland Wool Brokers example given above illustrates the ease of geographic expansion.

3.3.2. Existing Competition

Market Shares

Figure 11 provides wool market shares in the South Island, derived from Wrightson data.

Figure 11: Market Share by number of bales in the SI[51]

[Confidential]

Source: Wrightson.

Unilateral Effects

The merged PGG/Wrightson entity will be the largest broker in the South Island wool trading services market. Nevertheless, in our view the merged entity is unlikely to have the ability to unilaterally exercise market power, because of the large number of remaining competitors (over seventy) and the ease of expansion in this market, as already described above.[52]

The ability to expand is also illustrated by the experience of Country Wool Auctions, in the North Island. We are advised by PGG and Wrightson that in a very short time Country Wool Auctions has expanded its throughput to 17,500 bales.

Coordinated Effects

We also consider it unlikely that the merger will increase the prospects for collusion, because of:

- The large number of remaining players;
- The asymmetry in size between those remaining players, and the asymmetry in business models (e.g., broking versus direct sales); and
- The ease of expansion.

3.3.3. Potential Competition

The sheer number of firms in this market (seventy to eighty) suggests that there are no material barriers to entry. We have already discussed the ease of expansion within the wool trading services market. It is difficult to identify any barriers that a new entrant into the market would face.

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51 In the data provided by Wrightson, the figures were broken down by total bales sold by brokers in the North Island and total bales sold by brokers in the South Island. However, the figure for total bails sold by merchants was only available for the entire country, not broken down between islands. In order to estimate what percentage of merchant bales were sold in the South Island, we calculated the percentage of total broker bales sold in the South Island ([Confidential] percent) and multiplied this percentage by total merchant bales.

52 The Commission's merger acquisition guidelines state that " … non-coordinated effects that can arise in oligopoly markets in which there are small numbers of fairly evenly-matched businesses" (page 32). That requirement clearly does not apply to the present circumstances.

3.4. RURAL SUPPLIES

3.4.1. Introduction

We have kept our comments on rural supplies brief and focussed on the changing dynamics and general competitiveness of the sector. At an individual product level, we are not aware of any evidence suggesting that the proposed merger would raise competition concerns. Rather, our interest in this sector is that the extreme level of competition in it appears to be a key driver of the merger; as discussed in section 2 of this report, the traditional rural supplies business model is under pressure from new technologies, entry and sales channels.

3.4.2. Market Definition

Product Dimension

The approach of the Commission in the past when analysing rural supplies has been to define a "retail of rural merchandise" market. In effect, the Commission has defined a cluster market for rural merchandise, analogous to the supermarkets market.

While this approach may have been appropriate in the past, for the reasons discussed in section 2.3 of this report, we do not believe that it is the appropriate approach today. Rather, the evidence suggests that:

- Alternative sales channels are viable and compete with traditional retail stores; and
- Farmers unbundle their purchases of rural supplies.

For example:

- [Confidential] percent of PGG's rural supplies sales are arranged via on-farm representatives, rather than via farmers visiting a store.
- Grant Samuel notes that (page 11):[53]

  Wrightson is in the process of developing a new strategy for its Rural Supplies businesses away from being a predominantly store based business into a multiple distribution channel business, with an emphasis not only on direct sales but also through mobile account managers and a national call centre. The management of Rural Supplies has identified the possibility of servicing its clients through other channels including catalogue sales, internet sales and telephone sales.

- According to AC Nielsen data provided to us by Wrightson, [Confidential] percent of animal health supplies are sold by vets.

53 Grant Samuel (2004) "Independent Adviser's Report on The Partial Takeover Offer from Rural Portfolio Investments Limited".

- Ravensdown sells virtually all its fertiliser product directly to farmers. Furthermore, Ravensdown now sells agri-chemicals through that same channel.[54]
- Vets and other retailers such as the Warehouse also sell rural supplies. For example, according to Wrightson data, vets now sell [Confidential]% of over the counter animal remedies.
- We are advised by Wrightson that two out of four manufacturers of conventional fencing sell direct to farmers.

Accordingly, in our view markets should be defined along individual product lines.

Geographic Dimension

The traditional retail stores would have relatively narrow geographic catchment areas. However, direct sales and the Internet must be increasing the geographic boundaries, as discussed in section 2.3 of this report.

3.4.3. Existing Competition

The available evidence indicates that competitive pressures in the rural retail markets are very strong. Grant Samuel (2004) notes that (page 11):[55]

> *Margins are typically low and declining in the rural supplies industry, and the respective operators suffer from a relatively high fixed cost base.*
>
> *…*
>
> *Rural Supplies operates in a fiercely competitive market place which is grossly over servicing the market. There is a need for substantial rationalisation within the sector if any of the participants are to generate consistent and satisfactory maintainable earnings. A number of market participants have expressed their concerns with the Rural Supplies market*

Grant Samuel refers to the PGG Annual Report Commentary on PGG Farm Supplies, where it is stated:

> *The year under review produced a disappointing result from reduced sales levels and pressure on margins. The year was characterised by a highly competitive market with strong competition from new entrants.*

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54 Grant Samuel (2004) "Independent Adviser's Report on The Partial Takeover Offer from Rural Portfolio Investments Limited".

55 Grant Samuel (2004) "Independent Adviser's Report on The Partial Takeover Offer from Rural Portfolio Investments Limited".

PGG has provided us with financial performance data for its rural supplies business for the financial years ending June 2002 to 2005. PGG has calculated the economic value added (EVA) of its rural supplies business for each of these years. For commercial sensitivity reasons we do not set the results out here (we presume that PGG would be comfortable to provide them to the Commission separately). However, on the assumption that the EVA figures are calculated appropriately (we have not checked this), they do indicate that market conditions are extremely competitive.

The Wrightson 2004 Annual Report states (page 10):

> *The Rural Supplies business again performed poorly in 2003/04, with EBIT declining to $1.5 million from $3.7 million the previous year. A decline in sales reflected trading conditions, fierce competition from an over-serviced rural merchandise market, and the loss of fertiliser volumes now being sold direct to farmers.*

3.4.4. Potential Competition

The Commission in its Wrightson/W&K report found that barriers to entry and expansion are low in respect of rural supplies. The evidence discussed in our report is consistent with that finding.

3.5. Forage Seeds

3.5.1. Market Definition

Product Dimension

The term “forage seeds” refers to that group of seeds for all plants edible by livestock. Included within this set are a number of species, such as perennial ryegrass, Italian ryegrass, white clover and brassicas.

Within each of these species, there are competing, differentiated cultivars.

It may be that there would be sufficient substitution between species in response to a SSNIP to justify a finding that the market is a multi-species one; we have not investigated this hypothesis at this stage. However, we do note that the UK Office of Fair Trading (OFT) has found that there is supply-side substitutability in the breeding and development of different types of crops. OFT was reviewing the Limagrain/Advanta merger.[56] In its analysis of grasses, OFT divided the market into forage grasses, which are primarily used as animal feed, and amenity grasses, which are primarily used as lawns. Other categories of crops the OFT analysed included barley, maize, peas, onions and oilseed rape.

56 “Completed acquisition by Limagrain of the Advanta European Seed Business”, June 2005, Office of Fair Trading.

It is therefore probably most practical (given also the very large number of cultivars) to analyse competition at the aggregate "forage seed" level. This also appears to be the approach that the Commission adopted in the Wrightson/Hodder & Tolley decision.

Geographic Market

In the Wrightson/Hodder & Tolley decision, the Commission adopted a national market. This seems appropriate.

3.5.2. Existing Competition

The forage seeds market is very dynamic. The competing firms are continually investing in research and development in order to breed new and improved cultivars. Competition takes place not just on price, but also on innovation, characteristics and quality dimensions.

It is important to keep these factors in mind when analysing the market share data. From a public policy perspective, the primary concern should be to ensure that the merger does not materially alleviate the pressures on the merged firm to invest and innovate.

The expressed views of OFT are similar. OFT accepted that market share of supply is volatile and depends significantly on the success of new varieties. As a result, current statements of market share may not be a true reflection of market power. OFT pointed out that as a general rule, specific seed varieties do not experience high demand for more than a few years because new disease and mutations make them less resistant to disease, and continuous technological improvement means that superior products are continually becoming available. As a result of high product turnover in the market, OFT concluded that there is no incentive for a breeder to withhold a new type of seed from the market. OFT also noted that the long lead-time for development of new varieties of seeds means that seed companies must innovate continually in order to remain competitive.

As a result of the fact that market share may not be a reliable method of measuring market power, the OFT assessed the affects on competition by determining whether or not the merger reduced incentives to innovate or raised barriers to entry.

We have obtained estimated market share data from PGG, which is set out in Figure 12.

Figure 12: Market Share, 2003

[Confidential]

Across all species, the merged firm (PGG plus Wrightson plus Agricom) will have a share of approximately [Confidential] percent. It will face one other large player (New Zealand Agriseeds, with a share of [Confidential] percent), Cropmark ([Confidential] percent) and smaller players ([Confidential] percent).

We note that in the Wrightson/Hodder & Tolley decision, the Commission found that there are no significant barriers to entry to this market (we return to entry issues below). Of course, the barriers to expansion within the market will be even lower. We are advised that a firm such as Agriseeds could increase its production in order to meet demand from farmers switching away from the merged PGG/Wrightson entity in the face of a SSNIP within:

- 12 months in the case of a seed that required production within New Zealand; and
- 6 months in the case of a seed that required production in the Northern Hemisphere and then transport to New Zealand.

The ability to expand into the breeding of new species is demonstrated by the history of PGG's brassica business. While PGG had marketed on occasions imported brassica seeds since the early-1990s, it did not have a complete brassica cultivar portfolio until 2001. It now has approximately [Confidential] percent of the brassica segment of the market, with 6 cultivars.

One of the consistent themes in the rural services industry, across livestock trading, wool trading, retailing and seeds, is the importance of human capital relative to other inputs: in particular, the personal relationships between firm agents/representatives and farmers and the human skills in research and innovation. This in turn makes the firms vulnerable to key relationship staff leaving to go to other firms, or new entrants. Examples in the seeds area include:

- The present New Zealand Sales and Marketing Manager for Agricom was hired from Wrightson 18 months ago;
- The present Production Manager for Agricom was hired from Agriseeds 18 months ago; and
- Cropmark hired a plant breeder from Hodder & Tolley after that business was purchased by Wrightson.

3.5.3. Potential Competition

As noted above, in the Wrightson/Hodder & Tolley decision, the Commission found that there are no significant barriers to entry to this market. This finding has been corroborated by subsequent events:

- DLF established an office and trial sites in New Zealand 12 months ago. DLF is based in Denmark and is the world's largest seed company, representing approximately 25 percent of the world's forage and turf markets. DLF is trialling and multiplying its own cultivars in New Zealand for the New Zealand market.

- Germinal Holdings, a large international seeds business based in the UK, holds a 25 percent shareholding in a New Zealand seed company (P Cates Ltd in Ashburton). Germinal Holdings introduced a new ryegrass cultivar in the past year to New Zealand with claims that it has tested better for high sugar content than current commercial New Zealand marketed cultivars.

- Cropmark was originally a cooperative. However, after losing the support of its farmer shareholders and going through a management buy-out, Cropmark reinvented itself as a seeds business in about 2000. Cropmark hired a plant breeder from Hodder & Tolley after that business was purchased by Wrightson. Cropmark now has about a 6 percent market share.

In fact, it is the threat posed by firms such as DLF and Germinal Holdings that is part of the rationale for the merger of PGG and Wrightson. As noted earlier in this report, there have been mergers in the seeds industry worldwide, primarily driven by economies of scale in R&D. PGG and Wrightson believe that in order to compete with these large international firms, both in New Zealand and overseas,[57] they need to pool their R&D resources to reduce duplication and improve economies of scale. They argue that the outcome will be improved products, to the benefit of farmers.

To provide some perspective, we note that Monsanto's seeds and traits R&D budget is targeted at about 10% of sales. Last year Monsanto's R&D investment totalled more than US$500 million. We understand that the combined R&D budget of PGG, Wrightson and Agricom is approximately NZ$[Confidential].

In respect of the Limagrain/Advanta merger, OFT noted that seed breeding is a highly specialised, research based activity requiring significant start-up investment and lead time. Developing a new variety of seed can take up to twelve years. OFT also noted that the UK market is currently declining due in part to reforms of the Common Agricultural Policy. As a result, OFT believes that the barriers to entry are high.

Given:

- The ability for firms in New Zealand to contract with the CRIs for the technical breeding expertise; and

- That firms like DLF and Germinal Holdings have their own R&D capability already;

we consider that the merged PGG/Wrightson entity will be subject to a credible threat of entry and expansion, and will be incentivised to continue investing and innovating.

57 PGG competes in Australia, the US and certain South American countries. Wrightson competes in Australia and Uruguay.

APPENDIX H: MARKET SHARE OF SOUTH ISLAND AGENTS

Market Share of South Island Agents

Entity	No. of SI agents	% of Total
Wrightson	[ ]	[ ]
PGG	[ ]	[ ]
Merged Entity	[ ]	[ ]
Rural Livestock Limited	[ ]	[ ]
Peter Walsh & Associates Limited	[ ]	[ ]
South Island Dairy Farmers Limited	[ ]	[ ]
Southstock Limited	[ ]	[ ]
South West Livestock	[ ]	[ ]
Independents with 5 or less agents	[ ]	[ ]
Meat company agents	[ ]	[ ]
Total	[ ]	**100%**

Source: Wrightson

South Island Livestock Agents: Use of Saleyards

Trading Name	Number of Agents	Number of Current Agents Utilising Saleyards
PGG	[ ]	[ ]
Wrightson	[ ]	[ ]
Healey BA	[ ]	[ ]
Campbell Livestock Ltd	[ ]	[ ]
Nelson Livestock Services	[ ]	[ ]
CRT	[ ]	[ ]

South Island Livestock Agents

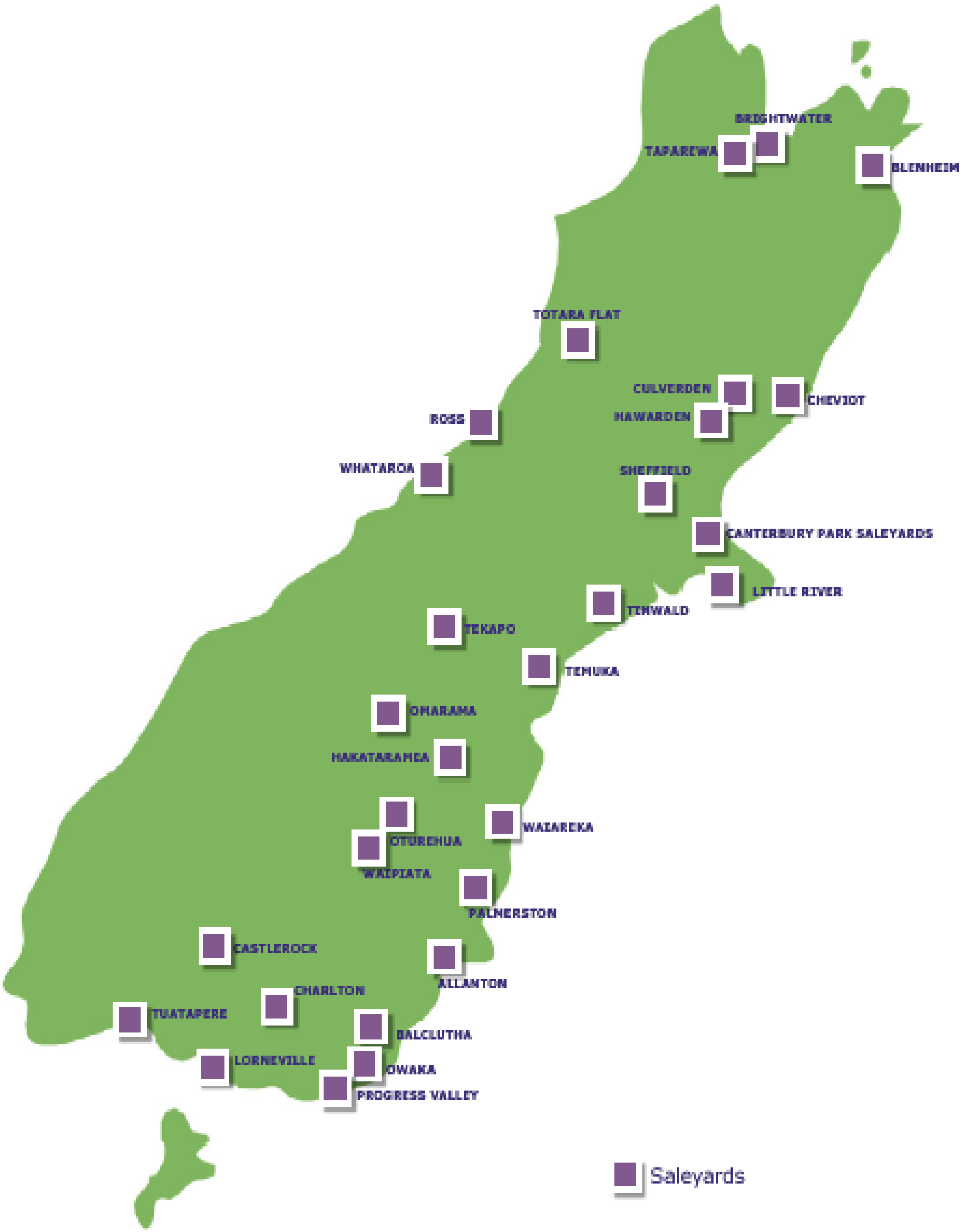
Trading Name	Number of Agents	Number of Current Agents Utilising Saleyards
Richard May Livestock	[ ]	[ ]
O'Brien Livestock	[ ]	[ ]
Kinzett Livestock	[ ]	[ ]
GD Saunders Ltd	[ ]	[ ]
Rural Livestock	[ ]	[ ]
Ellismere Livestock Ltd	[ ]	[ ]
McQueen Livestock	[ ]	[ ]
Ron Smith	[ ]	[ ]
South West Livestock	[ ]	[ ]
Birch Livestock	[ ]	[ ]
Peter Walsh Assoc	[ ]	[ ]
Kyle Livestock	[ ]	[ ]
Dave Taylor Livestock	[ ]	[ ]
20/20 Livestock	[ ]	[ ]
Victor Kirsten Livestock	[ ]	[ ]
Stock Co	[ ]	[ ]
Liz Wards Livestock	[ ]	[ ]
Harnett Livestock	[ ]	[ ]
Diedrich Livestock	[ ]	[ ]
Livestock Exchange (2002)	[ ]	[ ]
Livestock Marketing	[ ]	[ ]

South Island Livestock Agents

Trading Name	Number of Agents	Number of Current Agents Utilising Saleyards
K O'Connor Livestock	[ ]	[ ]
Provincial Livestock	[ ]	[ ]
South Island Dairy Farmers	[ ]	[ ]
Whitestone Livestock	[ ]	[ ]
Waitaki Livestock	[ ]	[ ]
Otago Livestock Ltd	[ ]	[ ]
Peter Grellet Livestock	[ ]	[ ]
Progressive Livestock	[ ]	[ ]
South Stock Limited	[ ]	[ ]
Total	[ ]	[ ]

Source: Wrightson

APPENDIX I: MAP OF SOUTH ISLAND SALEYARDS



APPENDIX J: OWNERSHIP OF SI SALEYARDS

Ownership of Saleyards

Name	Owner	Wrightson	PGG	Merged Entity	Other
Blenheim	Marlborough Saleyards Company Limited	1%	1%	2%	98%
Tapawera	Farmers	-	-	0%	100%
Brightwater	Farmers	-	-	0%	100%
Ross	Farmers	-	-	0%	100%
Whataroa	Farmers	-	-	0%	100%
Canterbury Park	Canterbury Saleyards (1996) Limited	50%	50%	100%	-
Cheviot	Farmers	-	-	0%	100%
Culverden	Farmers	-	-	0%	100%
Hawarden	Hawarden Saleyards (1953) Ltd	1%	1%	2%	98%
Little River	Farmers	-	-	0%	100%
Sheffield	Sheffield Saleyards Limited	33%	21%	53%	47%
Tinwald	Ashburton Saleyards Company Limited	50%	50%	100%	-
Temuka	Temuka Co-operative Saleyards Company Limited	1%	1%	2%	98%
Tekapo	Farmers	-	-	0%	100%
Waiareka	Oamaru Farmers' Saleyards Co Ltd	23%	14	38%	62%

Ownership of Saleyards

Name	Owner	Wrightson	PGG	Merged Entity	Other
Hakataramea	Farmers	-	-	0%	100%
Omarama	Omarama Saleyards Ltd	23%	14%	38%	62%
Oturehua		-	-	0%	100%
Waipiata		-	-	0%	100%
Palmerston	Palmerston Saleyards (1961) Ltd	27%	18%	45%	55%
Allanton		-	100%	100%	100%
Balclutha	Balclutha Saleyards Company Limited	13%	13%	25%	75%
Owaka	Owaka Saleyards Ltd	60%	40%	100%	-
Lees Stream	Farmers	-	-	0%	100%
Mt Benger	Mt Benger Saleyards Ltd	-	-	0%	100%
Cromwell	Cromwell Saleyards Company Limited	-	-	0%	100%
Omakau	Omakau Saleyards Ltd	21%	11%	32%	68%
Charlton	Gore Livestock Centre Limited	4%	1%	5%	95%
West Otago	West Otago Cattle Saleyards Company limited	23%	21%	44%	56%
Castlerock	Castlerock Saleyards Limited	5%	1%	6%	94%
Lorneville	Invercargill Saleyards Company Limited	21%	2%	23%	76%
Tuatapere	Tuatapere Saleyards Ltd	5%	1%	6%	95%
Progress Valley	Maurice Yorke	-	-	0%	100%

Source: Wrightson

APPENDIX K: DIRECT PROCUREMENT BY MEAT COMPANIES

Meat Companies operating in the South Island

Processor*	Number of Buyers
Alliance	[ ]
PPCS	[ ]
Canterbury Meant Packers	[ ]
South Pacific Meats - AFFCO	[ ]
Blue Sky Meats	[ ]
The Supply Chain	[ ]
Verkirk Meats	[ ]
Otago Venison	[ ]
ABCO Meats	[ ]
Total	[ ]

*There are some additional minor procurers of meat.

Source: Wrightson

APPENDIX L: NZ WOOL BROKERS MARKET SHARES

Market Share of Auction Service Providers

Broker	Total Broker Bales	Revenue @ [$38.85] per bale	Broker % Share	NZ % Share	No. of Reps	Bales per Rep
Wrightson North Island	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Primary Co-op	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Taranaki Farmers	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Country Auctions	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Wrightson South Island	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Pyne Gould Guinness	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
NZ Merino Co Ltd	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Primary Co-op	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Southland WB	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Wrightson N & S Islands	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Wrightson / PGG Nationwide	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
	[ ]	[ ]				
NZ Brokers	[ ]	[ ]	***100***	[ ]		
Merchants *	[ ]	[ ]		[ ]		
				[ ]		

* *(up to 70 private wool merchants, who source their wool by private treaty)*

** *(this figure is the market share of North Island Brokers only)*

Source:

2 New Zealand Wool Broker statistics
3 Tectra statistics
4 Best estimate broker non-auction
Period – 2003/04 season

Definitions:

Wool Merchant

Takes a principal position.
Buys wool direct from the wool grower.
Normally buys on a subjective basis.

Net Buying

Where wool is purchased and charges netted off.
Exception is Meat and Wool Levy and maybe insurance.

Wool Broker

Acts as an agent on behalf of the wool grower.
Wool sold mainly at auction on an objective basis.

APPENDIX M: SI RURAL SUPPLIES OUTLETS

Competitors in Rural Supplies in South Island Centres.

	Wrightson	PGG	CRT	FruitFed	ATS	RD1	Other	Total
Location								
Alexandra	1	1	1	1			1	5
Amberley	1	1					2	4
Ashburton	1	1			1	1	3	7
Balclutha	1	1	1			1	1	5
Blenheim	1	1	1	1			2	6
Cheviot		1					1	2
Christchurch	1	1	1	2			9	14
Clydevale		1						1
Cromwell	1						1	2
Culverden	1	1					1	3
Darfield	1	1	1				1	4
Dunedin	1	1	1				1	4
Dunsandel							1	1
Fairlie	1	1					2	4
Geraldine	1	1						2
Gore	1	1	1			1	5	9
Greymouth	1		1				1	3
Hawarden		1					1	2
Heriot		1						1
Hokitika							2	2
Invercargill	1	1	1			1		4

Competitors in Rural Supplies in South Island Centres.

	Wrightson	PGG	CRT	FruitFed	ATS	RD1	Other	Total
Kaikoura		1	1				1	3
Kurow	1	1					1	3
Lawrence	1	1					1	3
Leeston	1	1	1				1	4
Lumsden		1					1	2
Mayfield		1						1
Methven	1	1			1		2	5
Middlemarch		1						1
Milton		1					2	3
Mosgiel		1						1
Mossburn			1					1
Motueka	1		1	1			1	4
Murchinson		1						1
Nelson			1				1	2
Oamaru	1	1	1			1	3	7
Otautau	1	1					1	3
Outram	1							1
Owaka		1						1
Palmerston		1					1	2
Rakia		1			1		1	3
Ranfurly	1	1						2
Rangiora		1	1				2	4

Competitors in Rural Supplies in South Island Centres.

	Wrightson	PGG	CRT	FruitFed	ATS	RD1	Other	Total
Richmond	1		1	1			1	4
Riversdale							1	1
Roxburgh		1						1
Takaka	1						1	2
Tapanui		1					1	2
Te Anau	1						1	2
Temuka		1	1					2
Timaru	1	1	1				4	7
Tuatapere		1						1
Waikouaiti							1	1
Waimate		1	1					2
Wakefield			1					1
Westport			1				1	2
Whataroa			1					1
Winton	1	1	1				1	4
Wyndham		1						1
Total	**29**	**43**	**24**	**6**	**3**	**5**	**66**	**176**

Source: PGG

APPENDIX N: NEW ZEALAND DOMESTIC PROPRIETARY FORAGE SEED MARKET SHARE

Proprietary Seeds (excluding Forage Cereals) year end 2004

Company	Value ($m)	Market Share
New Zealand Agriseeds	[ ]	[ ]
Wrightson Seeds	[ ]	[ ]
PGG Seeds	[ ]	[ ]
Agricom	[ ]	[ ]
Cropmark	[ ]	[ ]
New Entrants	[ ]	[ ]
Total	[ ]	**100%**

Source: PGG

Proprietary Seeds (including Forage Cereals) year end 2004

Company	Value ($m)	Market Share
New Zealand Agriseeds	[ ]	[ ]
Wrightson Seeds	[ ]	[ ]
PGG Seeds	[ ]	[ ]
Agricom	[ ]	[ ]
Cropmark	[ ]	[ ]
New Entrants	[ ]	[ ]
Total	[ ]	**100%**

NOTE:

*** These figures do not include common seeds (which would dilute the merged entities market share). There is no market data available for commons, but the merged entity estimates they compromise between [ ] of all seeds sold;**

*** All figures represent final wholesale values (i.e. includes treatment);**

*** New entrants include DLF Seeds, Germinal Holdings, Specialty Grain & Seeds and others identified at para 21.14 – 21.17 of the application.**

APPENDIX O: MAP OF SOUTH ISLAND RURAL SUPPLIES STORES