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COMMERCE COMMISSION

Decision No. 730

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

GEA PROCESS ENGINEERING A/S

and

NU-CON LIMITED

The Commission:	Dr Mark Berry Gowan Pickering Dr Stephen Gale
Summary of Application:	The acquisition by GEA Process Engineering A/S (or any of its interconnected bodies corporate) of 100% of the shares in Nu-Con Limited.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
Date of Determination:	24 August 2011

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THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 1 July 2011. The Notice sought clearance by GEA Process Engineering A/S (GEA or the Applicant), or any of its interconnected bodies corporate, to acquire 100% of the shares in Nu-Con Limited (Nu-Con).

THE DECISION

2. The Commission considers that the markets relevant to its consideration of this application are the national markets for the supply of:
   - milk powder handling systems;
   - high output milk powder packaging systems; and
   - low output milk powder packaging systems.
3. The Commission considers that competition from existing participants in the affected markets is likely to be sufficient to constrain the combined entity. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets.

ANALYTICAL FRAMEWORK

4. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
   - with the acquisition in question (the factual); and
   - in the absence of the acquisition (the counterfactual).
5. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:
   - existing competition;
   - potential competition; and
   - other competition factors, such as the countervailing market power of buyers or suppliers.

KEY PARTIES

The Applicant - GEA

6. GEA designs and manufactures processing equipment used in the dairy, food, pharmaceutical, and chemical industries. GEA is part of the wider GEA Group, which is a multinational technology group based in Denmark. GEA's processing equipment includes industrial drying, powder handling and

packaging systems. GEA has one New Zealand manufacturing plant which is in Hamilton.

The Target – Nu-Con

7. Nu-Con is a private company that designs, manufactures and assembles a range of equipment that is used in dairy and food processing industries. Like GEA, Nu-Con designs and supplies handling and packaging systems for a variety of products. Nu-Con has assembly plants in Auckland, Australia and Singapore.

Other Parties

8. GEA and Nu-Con compete with a number of other companies for the design and manufacture of powder processing systems. These companies include:

   - Tetra Pak (New Zealand) Limited (Tetra Pak), which like GEA supplies a full range of powder processing systems;
   - Technopak Limited (Technopak), which is a packaging system supplier;
   - Techno Links New Zealand Limited (Techno Links), which supplies powder handling systems;
   - Powder Projects Limited (Powder Projects), which supplies powder handling systems; and
   - SPX Corporation (SPX), an American-based supplier of powder processing systems that has recently started to establish itself in New Zealand.

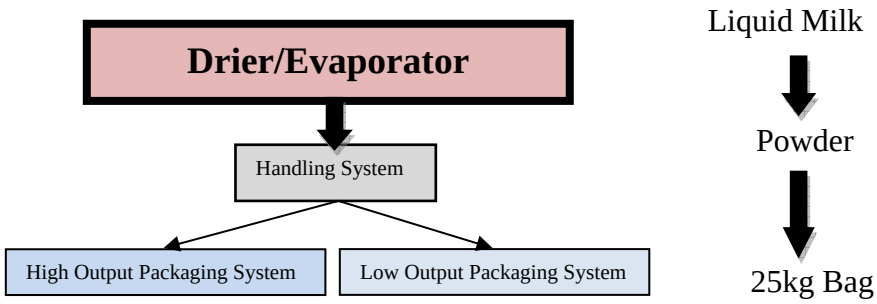
9. In New Zealand, the main application of these systems is for processing and packaging of milk powder. The main users of milk powder processing systems are dairy processing companies, such as:

   - Fonterra Co-operative Group (Fonterra);
   - Open Country Dairy Limited (Open Country);
   - Miraka Limited (Miraka); and
   - Synlait Limited (Synlait).

INDUSTRY BACKGROUND

10. Figure 1 outlines the key steps in the manufacture and the processing of milk powder. Initially, liquid milk is evaporated in a drier into a powder form. It is then conveyed (or 'handled') to the appropriate packaging system where is it packaged into 25kg bags, which are the industry standard.

Figure 1: Milk Powder Processing Systems



11. Industry participants advised that, historically, individual manufacturers supplied machinery for the individual stages of the processing system. However over the past 10-15 years, there have been amalgamations through acquisition and, as a result, equipment manufacturers are now able to provide customers with a range of processing solutions.

12. End-users advised that they have a preference to deal with manufacturers who can provide complete systems or "turnkey" solutions for such milk powder processing plants. For example, Fonterra and Open Country prefer to award turnkey contracts for the design, manufacture, installation and project management of an entire plant or plant upgrade.

MARKET DEFINITION

13. The Application concerns suppliers of various powder processing systems and machinery. These systems are designed to different individual specifications that the individual end-users require, then manufactured and installed and commissioned by the supplier. These systems are supplied on a national basis.

14. As a starting point, the Commission has considered whether the relevant processing systems are unique to the production of individual end products. The Applicant submitted that milk powder processing systems are not substitutable for processing systems for other food powders because the properties of milk powder require unique design and manufacture. In addition, there are significantly higher hygiene requirements for milk powder in comparison to other types of food products.

The processing of milk powder compared with other food products

15. The Applicant submitted that the exacting quality standards required by international dairy food customers and regulators means that there is a significant difference (in specification, price and manufacturing quality) between milk powder and other types of food processing systems – placing them in separate markets. According to the Applicant this separation is particularly relevant for the drying and handling stages of the process.

16. Certain equipment suppliers interviewed by the Commission considered that a generic food processing system could be easily upgraded to handle milk powder by using higher specification equipment. For example, all processing systems convert the product from bulk form into convenient packages regardless of whether the product is sugar, flour or milk powder. However, because milk powder is much finer than other products, it requires higher grade machinery with finer tolerances and all the stainless steel equipment needs to be polished to higher standards compared to other food products.

17. However, other equipment suppliers and the main dairy processors disagreed. They considered that the design and manufacture of a milk powder processing system was a specialist procedure due to the unique properties of milk powder, in particular, its fat content. For example, if it is not handled correctly, the milk powder can be easily damaged which can cause clogging in the system or actually change the ability of the powder to dissolve later down the supply chain. Many of these specialist designs have been patented and expertise, particularly in respect of high volume milk powder processing systems, has

become concentrated in New Zealand. Indeed, New Zealand technology in this respect is in demand internationally.

18. Given the latter submissions, the Commission considers it appropriate to consider that milk powder processing systems are supplied in discrete markets separate from processing systems for other food products (such as grains, flour, and sugars). This narrower focus will tend to highlight potential competition issues as industry participants all advised that there were fewer milk powder processing system suppliers than generic food processing system suppliers.

Different milk powder processing systems

19. As noted above, there are three stages in milk powder processing systems: drying, handling and packaging. The Applicant submitted that the equipment supplied for each of these stages is a distinct product and, in respect of packaging, that the product market should be further narrowed depending on the different output rates of packaging systems.

Milk powder drying systems

20. Driers are the most expensive component of milk powder processing plants. While GEA does supply driers, Nu-Con does not currently do so. All parties interviewed by the Commission advised that the expertise and equipment required to produce a milk powder drier are significantly different to the other components of the complete processing system. Accordingly, given there does not appear to be any aggregation of market share arising from the acquisition in this respect, the Commission will not further consider milk powder drying systems.

Milk powder handling systems

21. To connect the output of a milk powder drier to a milk powder packaging system, a conveyance or handling system is required usually comprising stainless steel blowers, pipes, valves, and storage vessels.

22. In the Commission's view, the design expertise and the handling equipment itself appears sufficiently different from milk powder packaging equipment to make each a distinct product market. Handling involves conveying large volumes of powder from the drier without damaging or interrupting the flow to the packaging line.

23. Accordingly, for the purposes of the present application, the Commission will consider milk powder handling systems as being supplied in a separate market.

Milk powder packaging systems

24. The Commission previously considered that powder packaging systems can fall into two discrete markets:

    - high output rate systems; and
    - low output rate systems.[1]

25. The key distinction is the output rate rather than the bag size. In most cases milk powder is supplied at wholesale in 25kg bags. The distinction is the rate at which such bags are filled and packaged.

[1] See *Decision 519: Niro / Colby Systems Limited* 30 March 2004.

26. The output rate of a packaging system obviously relates to the speed, capacity and size of the drier. A preference for high volume driers in New Zealand has meant that there has been a need for high output packaging systems. All the milk powder processing plants recently built in New Zealand have high volume driers and high output packaging systems installed.

27. GEA, but not Nu-Con, currently supplies high output milk powder packaging systems while Nu-Con, but not GEA, currently supplies low output milk powder packaging systems. [

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28. GEA advised that, [

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29. Given these facts, the Applicant considers that there is no aggregation of market share in packaging systems.

30. However, other packaging system suppliers such as [ ] and [ ] consider that it is possible to increase the output of a system from low output rate to high output rate, merely by increasing the number of packaging lines operating in parallel (assuming that any increased volume to the packaging lines could be satisfactorily supplied by the handling system). Some industry participants consider this to be a big assumption and the Commission notes that a number of low output milk powder packaging trains operating in parallel does not necessarily fit the definition of a high output system.

31. Most suppliers provide low output systems while only a few suppliers provide high output systems. End users [ ], submitted that there is a significant technical difference between the systems.

32. Accordingly, the Commission considers that for the purposes of the present application, there are separate markets for high output and low output milk powder packaging systems.

Conclusion on Market Definition

33. The Commission considers that the relevant markets are the national markets for the supply (which includes the design, manufacturing, installation, commissioning and project management) of:

- milk powder handling systems (the milk powder handling market);
- high output milk powder packaging systems (the high output packaging market); and
- low output milk powder packaging systems (the low output packaging market).

COUNTERFACTUAL AND FACTUAL

34. In the factual, GEA would acquire Nu-Con. GEA advised the Commission that the rationale for the proposed acquisition was to [

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35. Nu-Con advised that [

]

- [ ]
- [ ]
- [ ]

36. [ ]

37. Accordingly, the counterfactual would likely be Nu-Con continuing to operate either under its present ownership or under the ownership of an independent third party – essentially the status quo in competition terms.

COMPETITION ASSESSMENT

Overview of competition in the supply of milk powder processing systems

38. Table 1 indicates the main suppliers in the industry and outlines which markets they currently supply systems to. The proposed acquisition would create aggregation at the powder handling stage and at the low output packaging stage.

Table 1: Suppliers of Milk Powder Processing Systems

Parties	Applicant	Target	Other Suppliers			
	GEA	Nu-Con	Tetra Pak	Powder Projects	Technopak	Techno Links
Driers	✔	x	✔	x	x	x
Milk Powder Handling	✔	✔	✔	✔	x	✔
High output Packaging	✔	x	✔	x	✔	x
Low output Packaging	Not in the last 3 years	✔	✔	x	✔	x

Source: Industry participants

39. All industry participants stressed that the main competition in the industry, as a whole and in each of the respective markets, occurs between the vertically integrated GEA and Tetra Pak who are able to provide a turnkey solution to customers. Further, all the main customers considered that, in the factual, there would still be a number of other suppliers, in addition to GEA and Tetra Pak, in each of the respective product markets.

40. In this respect, industry participants did not express any significant competition concerns in respect of GEA's proposed acquisition of Nu-Con. Rather, they viewed the proposed acquisition as being a continuation of a series of industry mergers as suppliers have attempted to broaden their presence to have the ability to become turnkey suppliers.

41. Industry participants noted that it was difficult to accurately assess market shares in this industry because of the ways in which sales are made. Typically, sales are made through two types of tenders, namely:

- turnkey projects, under which the supplier tenders to supply the multiple stages of a milk powder processing system; and
- specific projects, under which the supplier tenders to supply a single stage of the processing system. This may occur because of a processors need to increase capacity of a bottleneck in its process, or to replace a section of its process due to it reaching the end of its useful life.

Turnkey projects

42. Milk powder processing systems in dairy plants have a life span of a minimum of 15-20 years. In this respect, industry participants advised that when a new plant is commissioned, all suppliers tend to compete aggressively for such work. As noted above, the trend is for customers to award tenders to a supplier who has the ability to offer a turnkey solution.

43. The Applicant, Nu-Con, Tetra Pak and the main customers all advised the Commission that GEA and Tetra Pak are the only suppliers of large turnkey processing systems. For example, Fonterra, Miraka and Open Country have all commissioned dairy plants in the last few years and GEA or Tetra Pak were the lead contractors for these projects. In this respect, Nu-Con submitted that when assessed in this regard, its market share would be negligible.

44. Nevertheless, dairy processers often require the lead contractor (i.e. GEA or Tetra Pak) to use a specific handling or packing system provided by a particular supplier. This means that other suppliers such as Nu-Con and Powder Projects also have a presence in these types of projects as sub-contractors.

Specific projects

45. Industry participants advised that for the smaller projects, particularly upgrades and maintenance work on existing plants, competitors such as Nu-Con, Powder Projects and Technopak were more prominent and competed directly with GEA and Tetra Pak for example.

The Milk Powder Handling Market

46. Table 2 shows the estimated market shares in the milk powder handling market. Given the different type of tenders described above, the Commission has assessed market share in two ways. Firstly, in respect of turnkey projects, market share has been assessed over the past five years as these projects can be lumpy and it takes a number of years for a greenfields dairy plant to be commissioned and then built. Secondly, market share has been assessed in respect of specific projects over the last year. These projects concern upgrades and maintenance on existing dairy plants.

Table 2: Market shares for the milk powder handling market

Parties	Turnkey projects between 2007-2011	Market Share over 5 year period	Specific projects for the 2010/11 year	Market Share 2010/11
GEA	[ ]	[ ]	[ ]	[ ]
Nu-Con	[ ]	[ ]	[ ]	[ ]
Combined entity	*[ ]*	*[ ]*	*[ ]*	*[ ]*
Tetra Pak	[ ]	[ ]	[ ]	[ ]
Powder Projects	[ ]	[ ]	[ ]	[ ]
Other (includes Asian suppliers)	[ ]	[ ]	[ ]	[ ]
Total	**[ ]**	**100%**	**[ ]**	**100%**

Source: The Applicant, industry participants and Commission estimates

47. Table 2 indicates that Nu-Con has been more active with specific project work than it has with turnkey projects although overall the level of aggregation in the market is not significant.

48. GEA and Tetra Pak are the main suppliers in this market. [ ], advised the Commission that Tetra Pak and GEA were the two options for turnkey projects, and that the proposed acquisition would not change that scenario.

49. Similarly, [ ] advised the Commission that it was not concerned with the proposed acquisition because the main competition in respect of turnkey projects would continue to occur between GEA and Tetra Pak. [ ][2]

50. In respect of competition for specific projects, Fonterra noted that Nu-Con would be removed from the market. However, [ ] considered that Powder Projects would remain a strong competitor for specific projects, along with GEA and Tetra Pak.

51. Table 2 does not include Techno Links or SPX. Techno Links is a small company established last year when two directors left Nu-Con [ ]

52. Industry participants advised the Commission that SPX is currently looking to establish itself in New Zealand and like GEA and Tetra Pak, it is fully vertically integrated and could supply all the relevant markets. In this respect, both Techno Links and SPX have the potential to supply into the milk powder handling market.

[2] [ ]

53. Accordingly, the Commission considers that the combined entity would be constrained by suppliers such as Tetra Pak and Powder Projects. In addition, there are other suppliers such as Techno Links and SPX who have the potential to compete in this market.

54. In some circumstances the potential for the combined entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition. The main customers for milk powder handling systems, the dairy processors, are all sophisticated purchasers and routinely switch between suppliers. In addition, customers such as [ ] structure their high value tenders to allow flexibility when dealing with potential suppliers.

55. In the factual, the removal of Nu-Con would lead to increased concentration in the market. This could potentially enhance the potential for co-ordination in the market. However, the Commission considers that the presence of strong existing competition and an active competitive tender process run by strong, informed customers would constrain any enhanced potential for co-ordination.

56. Overall, the Commission considers that the proposed acquisition is unlikely to raise any significant competition concerns in the milk powder handling market.

The High Output and the Low Output Packaging Markets

High Output Packaging Market

57. Both GEA and Tetra Pak are able to supply high output systems. However, Nu-Con does not supply a high output milk powder packaging system.

58. Nu-Con advised that [

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59. [

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60. As there is no aggregation (or likely potential aggregation) in respect of high output packaging, the Commission will not consider the high output packaging market any further.

Low Output Packaging Market

61. Nu-Con, Tetra Pak and Technopak are the main suppliers of low output packaging systems in New Zealand. GEA has not supplied a low output packaging system in New Zealand for over three years. Nevertheless, GEA could potentially supply low output packing systems and the proposed acquisition would remove this potential.

62. All industry participants considered that Tetra Pak and Technopak are strong competitors and are active in research and development. Industry participants advised the Commission that Tetra Pak and Technopak would continue to compete strongly with the combined entity post acquisition.

63. Accordingly, the Commission considers that the proposed acquisition is unlikely to raise any significant competition concerns in the low output milk powder packaging market.

Vertical Integration

64. Some industry participants, notably [ ], expressed some concern that the further increase in GEA's vertical integration could potentially foreclose specialist competitors from the packaging markets, particularly because in the factual the two main competitors in the industry would be large multinational companies.

65. Other parties did not have this concern. For example, customers such as [ ] and [ ], advised the Commission that specialist suppliers, whether in the milk powder handling market or in one of the packaging markets, would still be able to operate effectively in the factual in the relevant markets because:

- most turnkey suppliers cannot provide the complete range and need to sub-contract to specialist suppliers;
- dairy processers often require the lead contractor (i.e. GEA or Tetra Pak) to use a specific handling or packing system provided by a specialist supplier; and
- there will continue to be specific projects relating to upgrades and modifications of existing dairy plants which would not require a turnkey provider such as GEA or Tetra Pak.

66. In addition, the main customers for milk powder packaging systems, the dairy processors, are all sophisticated purchasers and structure tenders to allow flexibility when dealing with potential suppliers.

67. In this respect, the proposed acquisition is unlikely to create market power in any of the relevant markets. Accordingly, the increase in vertical aggregation in is unlikely to raise any significant competition concerns.

OVERALL CONCLUSION

68. The Commission has considered the probable nature and extent of competition that would exist subsequent to the proposed acquisition in the national markets for the supply of:

    - milk powder handling systems;
    - high output milk powder packaging systems; and
    - low output milk powder packaging systems.

69. The Commission considers that competition from existing participants in the affected markets is likely to be sufficient to constrain the combined entity.

70. The proposed acquisition is unlikely to create market power in any of the relevant markets and so the increase in vertical aggregation in unlikely to raise any significant competition concerns.

71. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets.

DETERMINATION ON NOTICE OF CLEARANCE

72. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to GEA Process Engineering A/S, or any of its interconnected bodies corporate, to acquire 100% of the shares in Nu-Con Limited.

Dated this 24th day of August 2011

Dr Mark Berry
Chair