

# **Cavalier Wool Holdings Limited**

## **Authorisation Application**

Date: 8 February 2011

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

Pursuant to s67(1) of the Commerce Act 1986 notice is hereby given seeking authorisation of a proposed business acquisition.

## EXECUTIVE SUMMARY

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### **The Application**

Cavalier Wool Holdings Limited (**CWH**) seeks authorisation to give effect to a transaction which will involve CWH (or an interconnected body corporate) acquiring control over New Zealand Wool Services International Limited's (**NZWSI**) wool scouring business.

### **Wool scouring in context**

Wool scouring is the process of washing greasy wool in hot water and detergent to remove the non-wool contaminants and then drying it. Wool that has not been scoured is "greasy wool".

Greasy wool produced by New Zealand growers is used by manufacturers and processors around the world to manufacture a range of products including carpets, interior textiles and apparel.

These end-users specify to wool merchants or directly to wool growers the type of wool they need in order to be able to manufacture the products they wish to sell. They generally demand "clean wool" which is wool that has been scoured.

### **Decline in demand for scouring**

The scouring industry is a relatively small part of the overall sheep meat and wool industry and relies heavily on an active and strong sheep farming industry.

It is not overstating the position to say that the New Zealand wool industry is in distress with sheep flocks rapidly reducing over the past ten years. In the last four years alone, sheep numbers have reduced by around 20% from approximately 40 million in 2006 to approximately 33 million today. This is less than half the peak of 70 million in 1982-1983.<sup>1</sup>

Indeed, in February 2010 the Wool Industry Taskforce described the state of wool sector as "perilous" and said that the future of sheep farming in New Zealand was at risk.

The continued and permanent retrenchment of the wool industry has materially reduced demand for wool scouring services and this will continue.

### **Diseconomies of scale have led to industry rationalisation**

As the Commission has recently recognised, the key driver of a wool scourer's profitability is volume. Greater volumes lead to material economies of scale benefits and reductions in unit costs.

The combination of reduced demand and the resulting diseconomies of scale created has led to a consequent (although not corresponding) decrease in scouring participants and capacity. Whereas there were 20 scour sites in 1994, today there are only five sites operated by two operators being CWH and NZWSI.

### **The rise of the Chinese wool scouring industry**

Not only has overall demand reduced, what demand is left has become even more contestable. The rise of the Chinese wool scouring industry

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<sup>1</sup> Stock Number Survey as at 30 June 2010, Beef + Lamb New Zealand, August 2010, pg 6.

has meant that already over 21% of all wool exports<sup>2</sup> (or 18% of the wool clip<sup>3</sup>) are scoured in China and that competition is intensifying:

- There are over 100 scour lines operating in China already (compared with five in New Zealand).
- A number of new scour lines have opened in China over the last 24 months. A new three line plant has been recently opened which CWH estimates provides more capacity than the scouring capacity in the entire North Island.
- Based on current pricing from Chinese scourers, it is 10-13 cents per greasy kg cheaper for a merchant to scour greasy wool in China than it is to have that same wool scoured by CWH in New Zealand and exported as clean wool. With its current cost structure, CWH cannot compete with this pricing.

The quality of wool scouring in China continues to improve (albeit that CWH believes it offers a better quality scouring service) and the extent of scouring in China indicates that it is commercially acceptable, particularly given Chinese based processors and manufacturers account for nearly one third of the world's wool use<sup>4</sup> and China accounts for 49% of the world's wool imports<sup>5</sup>.

However, the constraint imposed by Chinese scourers is not limited to greasy wool for which the ultimate customer is in China. For a number of reasons it applies to all New Zealand greasy wool:

- CWH has limited visibility over the ultimate destination of wool prior to setting prices and so cannot charge a lower tariff where Chinese scouring is in fact a viable option, and a higher tariff where Chinese scouring is not a viable alternative.
- In any event, given the importance of volume and CWH's dependence on continued custom from merchants, differentiated pricing would risk alienating its merchants and undermine CWH's ability to retain their volumes.
- It is becoming increasingly viable for a merchant to export greasy wool to China and then to re-export that wool in a processed or semi-processed form from China to a customer in another country.

**No substantial change in constraints**

In these circumstances, while the acquisition reduces the number of domestic scourers from two to one, the constraints on CWH will not be materially lower.

The primary constraints on CWH have been permanent reduction in the wool clip and the increasing constraint imposed by Chinese wool scourers. This has been borne out since March 2009. During the

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<sup>2</sup> Wool Exports July to June 2009-2010 (Table 6.1), Beef + Lamb New Zealand, available at <http://www.meatnz.co.nz/main.cfm?id=259>.

<sup>3</sup> Assuming 85% of New Zealand's wool clip is exported.

<sup>4</sup> In 2007, IWTO reported that China accounted for 32% of world wool use at the spinning stage and 29% of world wool use at the manufacturing stage. IWTO Market Information 2007, pg 2.

<sup>5</sup> IWTO Market Information 2010, Table 22, pg 27.

Commission's previous investigation, CWH said it would be constrained by these factors and the ability for merchants to either enter the market themselves or sponsor new entry (in either case alone or in combination).

Furthermore, CWH understands there to be a continued reluctance by some merchants to use NZWSI as a commission scourer because NZWSI also competes with those merchants in export markets.

Accordingly, the continuing constraint from overseas scourers/greasy wool exports combined with low barriers to entry, the continued ability for merchants to sponsor new entry and the overarching commercial driver to achieve volume gains and economies of scale, will continue to constrain CWH. A critical loss analysis carried out by NERA serves to illustrate the impact small losses of volume would have on CWH's bottom line.

**Demonstrable public benefits of the type previously accepted by the Commission**

In any event, the acquisition will result in such material and demonstrable benefits to the public that it should be permitted.

NERA has quantified the present value of those benefits as being in the range of \$40.84 million to \$82.09 million over five years.

The types of benefits claimed are not controversial in that they have been previously recognised by the Commission to constitute public benefits. Where possible, NERA has quantified the benefits using approaches previously endorsed by the Commission.

**Decreased costs and increased economies of scale**

The primary benefits (both commercial and public) arise from the consolidation of New Zealand's existing scouring capacity upon CWH acquiring control of NZWSI.

CWH will:

- close the physically/environmentally constrained NZWSI scours at Kaputone (Canterbury) and Whakatu (Hawkes Bay) and move those scour lines to the physically unconstrained CWH sites at Timaru and Awatoto;
- modify the NZWSI scours to match their specification to the CWH lines' specification so as to increase their run-rate and capacity; and
- extend its existing 2.4 metre Awatoto scour lines and NZWSI's 3.0 metre Whakatu and Kaputone scour lines so as to improve their performance.

None of this restructuring can or will take place absent the acquisition.

This restructuring will generate material cost savings and improved economies of scale.

CWH has every incentive to pursue these efficiency gains because they will enable CWH to offer a lower cost, higher quality scouring service, thereby improving CWH's ability to compete more effectively in an environment of declining demand and increasing low cost supply.

CWH will realise industry non-capital cost savings of \$[ ] per

year or \$[ ] million (in present value terms) over a five year period. This equates to approximately [ ] cents per greasy kg processed.

CWH also expects to reduce future industry plant capital costs by \$0.88 million (in present value terms) over a five year period.

CWH estimates the cost of achieving the rationalisation will be one-off costs of \$[ ] million and NERA has off-set this expense in the benefits analysis.

**Sale of surplus land for other uses**

The restructuring will enable the sale of the Whakatu and Kaputone sites for other uses. Applying the Commission's previous approach, this will result in a benefit of \$[ ] million.

**Improved scouring product**

The modifications and extensions required to bring the NZWSI plant up to CWH's specification and to extend the Awatoto scour lines will not only improve the efficiency of those lines, but will also mean CWH will provide a higher quality scouring service to merchants.

The benefit arises because the modifications being made will cause the clean wool produced to be "whiter" than would be the case absent those modifications.

This is of value to merchants – it enables them to meet a customer's clean wool whiteness specifications using a less white greasy wool mix (all else being equal). As whiter greasy wool attracts a premium, merchants have greater flexibility to augment their greasy wool inputs and reduce their raw material input costs while still meeting their customer's specifications.

This represents an improvement in the quality of CWH's scouring service.

NERA has assessed the benefit to New Zealand using the Commission's settled approach to estimating dynamic efficiency gains/losses as being in a range of \$[ ] million to \$[ ] million per year or \$[ ] million to \$[ ] million over five years (in present value terms).

**Enhancement of the New Zealand scouring industry**

While not quantified, the acquisition will act to strengthen and enhance New Zealand's wool scouring industry, an industry which employs 170 FTEs and contributes approximately \$60 million to the New Zealand economy.

New Zealand is not immune to the trends sweeping the scouring world associated with an aggressively expanding Chinese wool scouring industry. These trends have already seen the Australian, French, Italian and British wool scouring industries retrench to a point where they are competitively marginalised.

Indeed, while Australia grows significantly more wool than New Zealand it now has virtually no domestic scouring industry. Virtually all Australian wool is now scoured offshore, with a large proportion scoured in China.

There are also a range of other benefits which may arise from the opportunities provided by the consolidation inherent in the application.

**The benefits cannot be**

The benefits described above – arising as they do from industry

**achieved in the counterfactual**

consolidation – cannot and will not arise in any counterfactual.

While this application is presented on the basis of a “status quo” counterfactual, there is a range of equally and perhaps more likely scenarios that could play out.

Over recent years, many Australian scours have closed and the surplus plant has been acquired by Chinese wool scourers and relocated to China. There is every reason to believe they would acquire and do likewise with the NZWSI assets and hence there is every possibility that the counterfactual may involve the exit of the NZWSI assets from the New Zealand market.

**Limited competitive detriments**

For the reasons described, while the acquisition would consolidate the only two remaining domestic wool scour operators, CWH believes there would be limited competitive detriment even if the counterfactual was the status quo.

Nevertheless, CWH recognises that the Commission would typically have natural concerns about a transaction such as this.

CWH engaged NERA to estimate the detriments that would be said to arise using the Commission’s previous approach even if the acquisition was considered likely to reduce the competitive constraints faced by CWH.

In doing so, neither CWH nor NERA have sought to debate the merits of the Commission’s previous approaches but have simply applied those analyses to the current transaction.

Total detriments over five years based on this analysis could be \$3.03 million to \$34.58 million (in present value terms) depending on the assumptions made. To illustrate these on a per year basis, they comprise:

- allocative efficiency losses of \$0.85 million to \$1.75 million per year if CWH could increase prices by 5% and \$0.17 million to \$0.33 million per year if CWH could increase prices only 1% above competitive levels;
- productive efficiency losses of \$[ ] million (1% increase in costs) to \$[ ] million (10% increase in costs); and
- dynamic efficiency losses of \$[ ] million to \$[ ] million per year.

**Proposed acquisition should be authorised**

As indicated above, even adopting a worst case scenario by assuming a 10% price increase, 10% cost increase and a large fall in innovation, and assuming a very low quality uplift, the total benefits arising from the transaction (quantified and un-quantified) materially – by \$8.04 million<sup>6</sup> – outweigh any detriments that could be said to arise even before counting the un-quantified benefits.

On that basis, CWH believes that the proposed acquisition will result in

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<sup>6</sup> Using an internally consistent assumption as to elasticity of demand for both benefit and detriment calculations.

such a benefit to the public that it should be authorised.

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## Part 1: Transaction Details

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### 1. The acquirer – Cavalier Wool Holdings Limited

- 1.1 This notice is given by Cavalier Wool Holdings Limited (**CWH** or the **Applicant**). CWH's contact details are:

**Cavalier Wool Holdings Limited**

c/- Hawkes Bay Woolscourers  
Private Bag 6014  
Napier

Contact person: Nigel Hales  
Chief Executive Officer  
Cavalier Woolscourers Limited

Telephone: 06 834 1421/027 446 8163  
Email: nigel@hbws.co.nz

- 1.2 The Applicant requests that all correspondence is directed in the first instance to:

Bell Gully  
Vero Centre, 48 Shortland Street  
PO Box 4199  
Auckland 1140

Attention:	Phil Taylor Partner	David Blacktop Senior Associate
Telephone:	(09) 916 8940	(04) 915 6531
Fax:	(09) 916 8801	(04) 915 6810
Email:	phil.taylor@bellgully.com	david.blacktop@bellgully.com

- 1.3 CWH is 50%-owned by Cavalier Bremworth Limited (**Cavalier Bremworth**), which is itself a wholly-owned subsidiary of NZX-listed Cavalier Corporation Limited (together, the **Cavalier Group**).
- 1.4 The Cavalier Group is involved in the manufacture of woollen and woolblend carpets in New Zealand (through its subsidiaries Cavalier Bremworth and Norman Ellison Carpets Limited (**Norman Ellison**)). The Cavalier Group also ultimately owns Elco Direct Limited (**Elco Direct**), a wool procurement business, which is a service provider to both the wool industry and the Cavalier Group's carpet businesses. Elco Direct has wool buyers covering all major wool growing regions in the North Island.
- 1.5 The remaining 50% of CWH is owned in equal parts by the Accident Compensation Corporation and Direct Capital Investments Limited.
- 1.6 CWH through its wholly owned trading subsidiaries Hawkes Bay Woolscourers and Canterbury Woolscourers owns and operates wool scours in Awatoto and Clive (Hawkes Bay) and Timaru. Utilising these scours CWH cleans and processes greasy wool for domestic and export markets on behalf of New Zealand wool buyers and carpet manufacturers. Hawkes Bay Woolscourers also scours all the Cavalier Group's carpet wool requirements.
- 1.7 CWH also ultimately owns 50% of the shares in Lanolin Trading Co Limited (**Lanolin Trading**).

## 2. New Zealand Wool Services International Limited (NZWSI)

2.1 New Zealand Wool Services International Limited (NZWSI) is a publicly owned company listed on the NZAX.

### New Zealand Wool Services International Limited

30 Sir William Pickering Drive  
Christchurch 8053

P O Box 29383  
Christchurch

2.2 NZWSI operates two businesses:

- (a) The first is the purchase of wool in New Zealand, primarily for export to a number of overseas countries, including India and China.
- (b) Secondly, it owns and operates wool scouring at Whakatu, Hawkes Bay (Whakatu Wool Scour Limited) and in Kaputone, just north of Christchurch (Kaputone Wool Scour Limited).

2.3 NZWSI also ultimately owns 50% of the shares in Lanolin Trading.

2.4 NZWSI's major shareholders are Plum Duff Limited and Woolpak Holdings Limited (in receivership) which together hold 63.8% of NZWSI. Of the remaining shares, 10% are held by NZWSI management and directors and 23% by 3,800 other shareholders, mainly wool growers.

2.5 On 16 December 2010, the receivers of South Canterbury Finance Limited (in receivership) appointed Maurice Noone and Malcolm Hollis, partners from PricewaterhouseCoopers, as joint receivers of Plum Duff Limited and Woolpak Holdings Limited. The receivers' contact details are:

Malcolm Hollis / Maurice Noone  
PricewaterhouseCoopers  
188 Quay Street  
Auckland 1010

2.6 The major assets of each company are their shareholdings in NZWSI. The receivers have indicated an intention to sell those shareholdings.

2.7 Plum Duff Limited is owned by Mr Alan Hubbard, who is under statutory management. Woolpak Holdings is owned by Raymond Lund of Timaru.

## 3. Interconnected and associated companies

3.1 See responses to question 1 and 2 above.

3.2 Most relevantly, CWH and NZWSI are equal shareholders in Lanolin Trading. Lanolin Trading is a co-operative, currently owned in equal shares by CWH and NZWSI.

3.3 It is involved as agent for its shareholders in the purchase and marketing of raw wool grease, a by-product of wool scouring. The company sells 90% of raw wool grease to overseas customers, with the remaining 10% purchased by a small number of New Zealand firms. Customers refine the raw wool grease for use as an input in a wide range of intermediate and final products (e.g., lanolin and lanolin derivatives such as cosmetics).

3.4 In addition, NZWSI owns 50% of Rural Wool Link Limited (**RWL**), with the remaining 50% owned by Mike Youngman. RWL is a wool buyer which operates in the North Island and on-sells wool to NZWSI.

#### **4. The proposed acquisition**

4.1 The proposed acquisition will involve CWH (or an interconnected body corporate) acquiring control over NZWSI's wool scouring business.

4.2 On acquiring control, CWH will merge NZWSI's and CWH's wool scouring operations and cease wool scouring operations at NZWSI's wool scours at Kaputone and Whakatu and its own operations at Clive. CWH will relocate the scour lines to its own unconstrained CWH sites at Timaru and Awatoto thereby increasing capacity at those sites. CWH will then sell the Kaputone and Whakatu sites. This restructuring is described in more detail in response to Question 5 below.

4.3 As the Commission is aware, NZWSI operates both as a wool exporter/merchant and as a wool scourer. CWH is not a wool exporter/merchant and has no intention of expanding its business to become one. Accordingly, post acquisition it does not intend to remain the owner of the wool exporting/merchant business.

4.4 At this stage it is unclear precisely what form the acquisition will take, although the net effect is that CWH and NZWSI will no longer be independent wool scouring competitors.

4.5 Accordingly, CWH or any interconnected body corporate of CWH seeks authorisation to acquire up to 100% of:

- (a) NZWSI's wool scouring assets<sup>7</sup> or any interconnected body corporate of NZWSI; and/or
- (b) the shares in NZWSI.

#### **5. Commercial rationale for the acquisition**

5.1 The commercial rationale for the acquisition has its genesis in the significant changes which have taken place in New Zealand's agricultural, and broader, economy over the last two and a half decades.

5.2 As the Commission has recognised, wool scouring is a volume driven business and a scourer's ability to effectively compete is dictated to a large degree by the extent to which it can obtain greater efficiency in its processes.

5.3 However, the wool scouring industry faces challenges in terms of both reducing demand and increasing supply from offshore suppliers of similar services. Loss of volumes generates diseconomies of scale which further undermines the ability for New Zealand scourers to compete to supply scouring services.

5.4 This transaction provides CWH with a path to addressing and responding to those challenges. Put simply, it will enable CWH to gain increased economies of scale and thereby enable it to compete more effectively with offshore scourers to supply scouring services in respect of New Zealand's greasy wool.

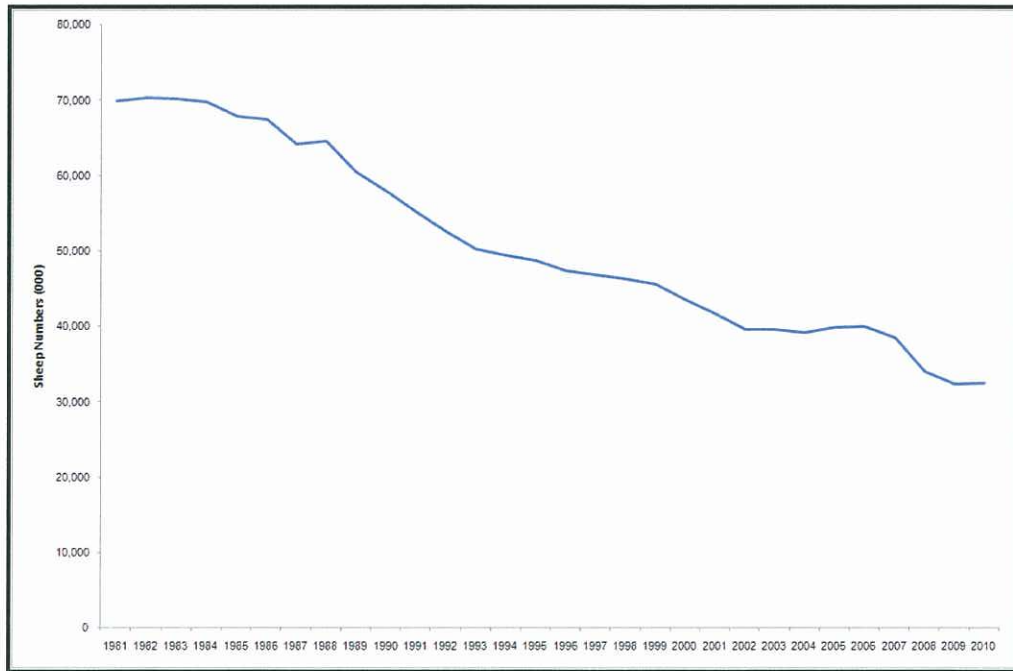
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<sup>7</sup> Being the wool scouring assets and stock located at Whakatu and Kaputone and 50% of the shares in Lanolin Trading.

**Wool scouring demand is a function of the size of New Zealand’s sheep flock**

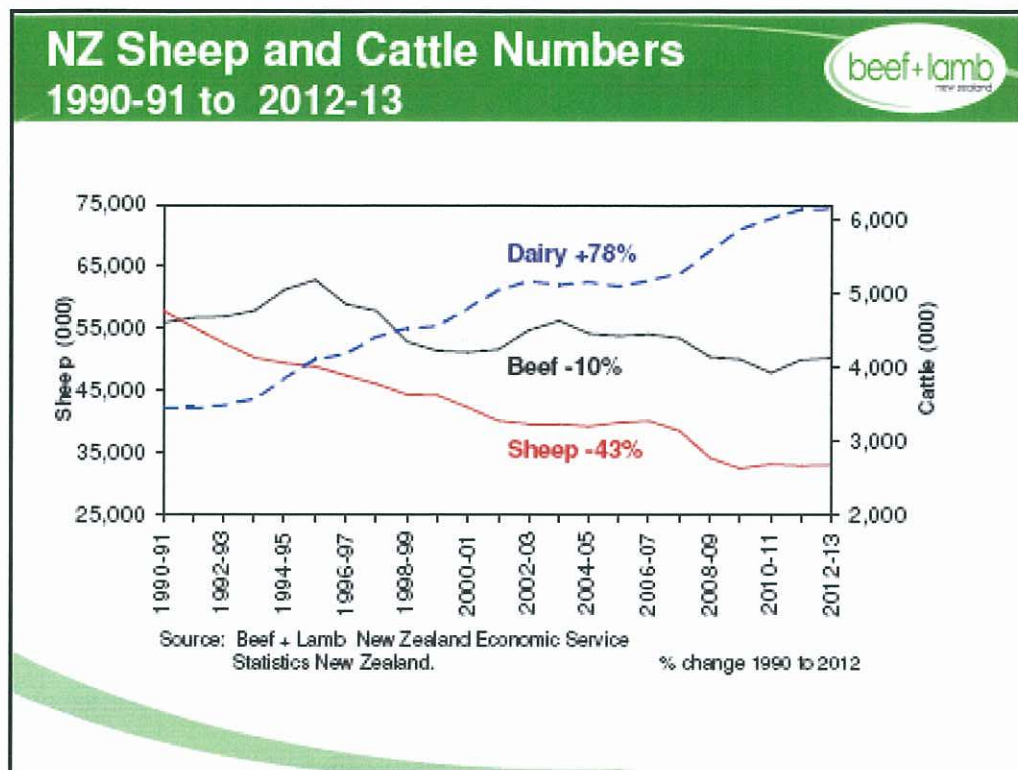
- 5.5 As wool scouring demand is a function of the size of New Zealand’s wool clip, the health of that broader industry necessarily impacts on the wool scouring industry. New Zealand’s sheep flock has decreased from the peak of 70 million in 1983 following the government’s introduction of the Supplementary Minimum Prices. This massive sheep population generated a large wool clip which predicated a need for numerous scouring operations.
- 5.6 Today, the sheep flock is 33.2 million.<sup>8</sup> The fall in New Zealand’s sheep numbers is illustrated in Figure 1 below. This illustrates that in the last five years there has been a further step change reduction in sheep numbers from approximately 40 million in 2006 to today’s level of 33.2 million. This represents a nearly 20% fall over this period.

**Figure 1: New Zealand sheep flock 1981-2010 (Statistics NZ)**



<sup>8</sup> Stock Number Survey as at 30 June 2010, Beef + Lamb New Zealand, August 2010, pg 6.

Figure 2: Beef + Lamb New Zealand forecasts to 2013



- 5.7 As the Commission recognised, the reduction in the wool clip has resulted in substantial declines in scouring capacity from more than 20 sites in 1994 to five sites today.
- 5.8 New Zealand is not unique in this regard. The continued reduction in scouring capacity to meet a reducing wool clip mirrors experience in a number of countries where there has been a significant reduction in scouring capacity, e.g., the United Kingdom, Australia, Russia and most of Europe. By way of example, the United Kingdom now has only two commission wool scours for the whole market (one of which is running at very limited capacity)<sup>9</sup> and in Australia there are no scours in the western region and just two<sup>10</sup> scours in the eastern region.
- 5.9 Nor is there is any reason to be optimistic that the sheep flock will increase given international returns and the permanent conversion of many sheep farms to dairy, in addition to the impacts of a number of droughts and storm effects. The potential for land to be converted to dairy farming is ongoing and its effects are permanent.
- 5.10 While wool prices have increased in the last couple of months, Beef + Lamb are not forecasting sheep numbers to increase; rather, they are forecasting sheep numbers to stay at or decline slightly from current levels.
- 5.11 Notwithstanding the recent recovery in wool prices, it is not overstating the position to say that the New Zealand wool industry remains in distress. The Wool Industry Taskforce in its Final report in February 2010 started its executive summary with the following comment:

<sup>9</sup> There is a third scour, although that is not understood to commission scour for third parties.

<sup>10</sup> There are also two other plants, but these are specialist processors (concentrating on scouring wool contaminated with vegetable matter and involving a process of carbonisation). The overall process is complex and scouring is a relatively small part of the overall process. These are both relatively small plants. New Zealand does not have any scouring carbonisation processors due to low levels of vegetable matter affecting the greasy wool.

There is no silver bullet for restoring profitability to the strong wool sector. Addressing the sustained decline in prices and volumes of wool exported from New Zealand over the last four decades will take concerted effort and commitment from within the wool and textiles sector. The challenge is real and immediate. The perilous state of the wool sector is placing the future of sheep farming in New Zealand at risk.

- 5.12 There is no doubt the recent increase in wool prices is beneficial and has been welcomed by all in the industry, however, its effect has been dampened by the detriment arising from recent climatic events – storm, droughts etc. CWH believes these returns remain below the level necessary to materially restock the sheep flock and significant further initiatives are needed to improve returns.
- 5.13 In this context, this transaction reflects one step in maintaining and enhancing value within New Zealand's wool industry by adding value to greasy wool grown in New Zealand.

### **Increased competition for wool scouring services**

- 5.14 The impacts of this steady decline in available demand have been further exacerbated by the emaciation of New Zealand's wool processing industry due, primarily, to the growth of low cost textile and apparel manufacturing in developing countries, most notably China.
- 5.15 This has led to the growth in exports of greasy wool to China and more recently the increase in the capacity of the Chinese wool scouring industry. This has made the ever decreasing wool scouring demand even more contestable.
- 5.16 The Chinese wool scouring industry is expanding aggressively and in line with the general manufacturing growth in China. Since China's economic reforms the Chinese market has grown at unprecedented rate and, in the last decade, this has seen the rise of an enormous middle class and a very large affluent class.
- 5.17 These wealthy individuals aspire to many of the same symbols of luxury that we see in New Zealand; they drive luxury German cars and buy Italian fashion. They also value pure and natural qualities and prefer wool carpets over synthetic alternatives. Consequently there is a large and growing market in China for luxury woolen carpets; specifically for businesses, 4 and 5 star hotels and for wealthy residences. In some cases these carpets are individual works of art; hand crafted to individual patterns, designed to specifically fit individual rooms and with hand-carved textures to add emphasis to the pattern. This demand continues to grow.
- 5.18 China is the largest manufacturer of textiles and clothing in the world accounting for nearly one third of the world's raw wool used for processing and manufacturing. The Chinese wool industry has responded and China is now the world's second-largest grower of wool. It is also the largest importer of raw wool accounting for 49% of the world's wool imports. This has grown from 3% in 1990 reflecting an increase in imports from 35,000 tonnes in 1990 to 305,377 tonnes in 2009. It does not export raw wool (prior to it being processed) to any material extent.
- 5.19 As China has developed its own wool industry, significant industry infrastructure has also developed and there is now a significant and growing scouring industry. As wool processing moved to China to supply integrated mills the scouring has moved as well. This has been particularly driven by the requirement to co-locate scouring with mill production, minimising the transportation damage to fibre. CWH understands that the top 18 scour lines in China alone have a combined capacity of nearly twice New Zealand's scouring capacity.

- 5.20 As described, this growth makes the issues facing the New Zealand scouring industry even more acute. In the 12 months to June 2010, 38% of New Zealand's wool exports were sent to China; 57% of those exports are in greasy form.<sup>11</sup> In other words, today, 21% of New Zealand's wool exports or 18% of New Zealand's entire wool clip<sup>12</sup> is being exported to China in greasy form.
- 5.21 On top of this growing constraint it remains the case – as the Commission concluded in 2009 – that merchants (either individually or collectively) would have the incentive to either sponsor entry, or to enter themselves if they faced a price increase of 5-10%.<sup>13</sup> This would result in a permanent loss of business for CWH, and as the Commission concluded “[g]iven the importance to CWH that it maintains high capacity utilisation, even the threat of entry may be sufficient to constrain the combined entity”.<sup>14</sup> This conclusion applies equally whether volume is lost to Chinese scourers or to merchant enabled new domestic entry.

### Rationalisation resulting from the proposed acquisition

- 5.22 The commercial benefit to CWH from the acquisition lies in the economy of scale benefits arising from the rationalisation of the existing NZWSI scour lines with the existing CWH scour lines and, hence, the ability to generate incremental economies of scale benefits. The ability to drive incremental volumes to lower per unit costs of production allows a scourer to offer a more cost competitive product so as to effectively compete for greater volumes and further reduce unit costs.
- 5.23 CWH has modelled the financial benefits based on the cost savings it will generate (enclosed with this application). CWH has not forecast any increase in scouring prices because for the reasons outlined in this Application, it does not believe that it will be able to achieve increased prices.
- 5.24 CWH forecasts the proposed acquisition and the restructuring will deliver \$[ ] million in incremental EBITD. This improved EBITD results almost solely from economies of scale cost savings and the processing of all wools through upgraded Awatoto and Timaru scours as CWH's analysis assumes (at least initially) only a minor increase in volumes scoured (0.2%). In reality, CWH believes the acquisition will enable it to compete more effectively to hold existing volumes and obtain additional volumes. These additional volumes would add to the commercial benefits it would derive from the transaction. To do that CWH has to be able to effectively compete with overseas scourers.

#### A. Context of the rationalisation

- 5.25 CWH currently has three scour lines in the North Island (two 2.4 metre scour lines at Awatoto and one at Clive) and two scour lines at Timaru in the South Island (one 3.0 metre scour line and one 2.4 metre scour line). NZWSI has a 3.0 metre scour located at each of Whakatu in the Hawkes Bay in the North Island and Kaputone near Christchurch in the South Island.
- 5.26 The end result of the rationalisation will be the mothballing of two scour lines – the one at Clive and the 2.4 metre scour line at Timaru – and the removal of duplication of two sites but, for the reasons described later, with no reduction in available capacity.

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<sup>11</sup> In the 12 months to June 2010, 46,282 tonnes of wool (greasy, scoured and slipe (clean equivalent)) were exported to China. New Zealand's total exports of all wool (greasy, scoured and slipe) were 122,893 clean equivalent tonnes. Greasy wool comprised 26,384 tonnes (clean equivalent) of the 46, 282 tonnes (clean equivalent) exported to China. Wool Exports July to June 2009-2010 (Table 6.1), Beef + Lamb New Zealand, available at <http://www.meatnz.co.nz/main.cfm?id=259>.

<sup>12</sup> Assuming that approximately 85% of New Zealand's wool is exported.

<sup>13</sup> Decision 666, para 173.

<sup>14</sup> Decision 666, para 174.



***CWH's scour lines today***

- 5.27 Given the efficiency benefits from achieving increased throughput, CWH has continued to incrementally and innovatively upgrade its scour lines by making modifications to maximise throughput.
- 5.28 The 3.0 metre line at Timaru, being the newest CWH line, is the most developed and unconstrained, and represents CWH "best practice". It is operating at a level of efficiency and output materially above the level of NZWSI's scour lines.
- 5.29 The two 2.4 metre scour lines at Awatoto have also been incrementally developed. Significant gains have been in terms of increasing throughput on those scour lines, and they are operating more efficiently than the existing NZWSI lines. However, CWH considers throughput could be further enhanced by applying the principles it has used in maximising the performance of the Timaru 3.0 metre scour line.
- 5.30 One of the key constraints at Awatoto is that the CWH scour lines are configured in a dog-leg fashion due to the existing size of the Awatoto buildings. This configuration slows down the scouring process. Correcting this layout cannot be done without extending the buildings.
- 5.31 While there are no site/environmental constraints to extending the building, it would cost in the order of \$[ ] million. While efficiency benefits will arise by doing so, the resulting revenue gains are not at a level sufficient to justify this level of expenditure.

***NZWSI scour lines today***

- 5.32 CWH believes there are efficiency gains to be made on the NZWSI lines as a result of applying the process developments it has achieved in Timaru and to a more limited extent at Awatoto.
- 5.33 While NZWSI already has some of the equipment necessary to make the modifications to its lines, those gains cannot be realised absent this transaction primarily because site constraints at Whakatu and Kaputone (both physical and/or environmental) prevent further development of the scour lines or the addition of new scour lines.
- 5.34 The efficiency benefits available by bringing these NZWSI scours up to "CWH spec" plus the ability to avoid the duplicated costs of running two additional sites provides CWH with an incentive to relocate these scours, a process which in itself is reasonably straightforward.

***Relocation requires capital investment in the North Island***

- 5.35 While the relocation process is simple in itself, the Awatoto buildings are currently not large enough to accommodate the 3.0 metre scour line – extensions to the building (there are no site constraints at Awatoto) will be necessary.
- 5.36 Making these extensions to the building will have the added benefit of enabling the 2.4 metre scour lines to be modified simultaneously so as to improve their efficiency.
- 5.37 The benefits of the consolidation possible through the acquisition coupled with the incremental efficiency benefits on the 3.0 metre scour line and the ability to now implement the desired changes to the 2.4 metre scour lines and realise the efficiency gains from that line, are more than sufficient to justify the \$[ ] million investment, i.e. it is now economic to approve the capex.

**B. Detail of North Island rationalisation*****Relocation of the Whakatu 3.0 scour line***

- 5.38 For the reasons outlined above, CWH will relocate NZWSI's 3.0 metre scour line, currently at Whakatu, to the CWH site at Awatoto.
- 5.39 The immediate benefits of this will be that CWH will be able to avoid the duplication of cost associated by closing the Whakatu plant and spread Awatoto's operating and administration costs over a much greater volume of production thereby reducing per unit costs.
- 5.40 As described in the summary above, there can be only limited further expansion of the NZWSI scour line at Whakatu in its current location.
- 5.41 More specifically this is because the Whakatu site is small and size constraints impact the layout of the scour line which is also installed on a 90 degree basis. Size constraints have also meant that the scour line is not optimally set up. Specifically, CWH considers that a lack of opening equipment and the length of the scour bowls are inhibiting performance of the line. CWH estimates that the Whakatu line operates at a capacity of [ ] greasy kgs per hour, which compares unfavourably with CWH's 3.0 Timaru wool scour, which operates at [ ] greasy kgs per hour based on South Island cross-bred wool types but at [ ] greasy kgs per hour when running on similar wool types to those processed in the North Island.
- 5.42 NZWSI has limited potential to expand the site to address these issues. Nor would CWH be able to do so, post transaction, if it did not relocate the scour line. This is in large part because the Whakatu site is landlocked with residential housing all around. CWH is aware that the neighbours surrounding Whakatu regularly complain about noise and smell; CWH is also aware that NZWSI have been involved in disputes with the neighbours and one is now on a court restraining order. Accordingly, resource consent to extend the buildings or install a second line is highly unlikely.
- 5.43 Moving the scour line to Awatoto will thereby enable CWH to expand capacity on the NZWSI scour line. CWH believes it can achieve significant efficiency improvements by making the following additional modifications:
- (a) reconfiguring the bowls to enhance the rinse capacity;
  - (b) modifying bowl 6 to become a longer shallow bottom chemical treatment bowl;
  - (c) installing jet spray bars on the rinse bowls;
  - (d) fitting a seventh squeeze press before the dryer;
  - (e) modifying the dirt loops and wool grease recovery system;
  - (f) installing a rumbler; and
  - (g) modifying the wool sorting area.
- 5.44 These modifications will not only bring the Whakatu scour up to the standard of the Awatoto scours (as they are configured today), it will go further and bring the scour line up to CWH best practice as represented by its Timaru 3.0 metre scour line. For all intents and purposes, the modified Whakatu and Timaru 3.0 metre scour lines will be identical.
- 5.45 Management have set their initial budgets conservatively on the basis that the modifications will result in an increased throughput to [ ] greasy kg per hour, although they believe the scour is likely to deliver up to [ ] greasy kg per hour.

***Expanding Awatoto and modifying the CWH scour lines***

- 5.46 As described above, realising the synergy benefits from relocating the Whakatu line will require CWH to modify the Awatoto building in a way that will enable CWH to also make the necessary modifications to its existing 2.4 metre lines so as to bring them up to the Timaru scour best practice level. This will generate increased throughput and efficiencies.
- 5.47 Specifically, CWH will:
- (a) extend the Awatoto buildings;
  - (b) straighten the scour line out post bowl number 6;
  - (c) replace the small rinse bowls with double hopper bowls;
  - (d) add a longer chemical bowl; and
  - (e) include the spare triple drum opener in the blending system.
- 5.48 In effect, the acquisition enables the cost of the extensions to be shared over a greater incremental gain in scouring volumes while also enabling CWH to realise operating and administration costs savings from exiting the Whakatu site. Making the 2.4 metre modifications makes economic sense in those circumstances (particularly given CWH owns much of the necessary equipment). The combination of the increased capacity benefits of extending and developing the existing Awatoto 2.4 metre lines and adding the NZWSI 3.0 metre line to that scour mean that the Clive site can cease to be run and can be moth-balled.

***Moth-balling the Clive plant***

- 5.49 Currently the Clive plant is utilised to cover emergencies and peaks in demand. It is operated only around 62 days per year and is hence costly capacity. Clive will no longer be required to run post acquisition. This is because post restructuring, CWH will have sufficient scouring capacity at Awatoto to cover expected demand in the North Island without the need to maintain the Clive plant.
- 5.50 While Clive will no longer be required, CWH has yet to make a decision on the future of the Clive plant and it will be mothballed in the interim as it may be retained to provide for business continuity in the event of one of the plants becoming unavailable (due to natural disaster/fire etc).

***Overall commercial benefits in North Island***

- 5.51 CWH has calculated the acquisition would:
- (a) reduce its administration costs from [ ] cents per kg greasy to [ ] cents per kg greasy;
  - (b) reduce its scour operating expenses (from scouring and pressing) from [ ] cents per kg greasy to [ ] cents per kg greasy;
  - (c) increase its EBITD from [ ] cents per greasy kg to [ ] cents per greasy kg.
- 5.52 In addition, CWH will be able to sell the Whakatu land and buildings realising an estimated \$[ ] million.
- 5.53 CWH believes the cost of the building and plant capital works at Awatoto needed to achieve this rationalisation to be a one-off cost of \$[ ] million.

**C. Rationalisation in the South Island**

- 5.54 Post acquisition CWH will control two scour sites in Canterbury (Timaru and Kaputone).
- 5.55 The primary benefit in the South Island results from the relocation and development to CWH best practice of NZWSI's 3.0 metre scour line, currently at Kaputone, to the CWH site at Timaru in replacement for the existing 2.4 metre line which will be mothballed.
- 5.56 The immediate benefits of the relocation will be that CWH will be able to avoid the duplication of cost by closing the Kaputone plant and spread Timaru's operating and administration costs over a greater volume of production thereby reducing per unit costs.
- 5.57 CWH has calculated the acquisition would:
- (a) reduce its administration costs from [ ] cents per kg greasy to [ ] cents per kg greasy;
  - (b) reduce its operating expenses (from scouring and pressing) from [ ] cents per kg greasy to [ ] cents per kg greasy;
  - (c) increase its EBITD from [ ] cents per greasy kg to [ ] cents per greasy kg.
- 5.58 In addition, CWH will be able to sell the Kaputone land and buildings realising an estimated \$[ ] million.
- 5.59 CWH believes the cost of the building and plant capital works at Timaru needed to achieve this rationalisation to be a one-off cost of \$[ ].

**6. Transaction documents**

- 6.1 There are no transaction documents available.

**7. No overseas dimension**

- 7.1 The proposed acquisition has no overseas dimension element.

**Part 2: The Industry**

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**8. Services supplied by CWH and NZWSI**

- 8.1 As described above in response to Questions 1 to 3:
- (a) CWH through its wholly owned trading subsidiaries Hawkes Bay Woolscourers and Canterbury Woolscourers owns and operates wool scours in Awatoto and Clive (Hawkes Bay) and Timaru. As a commission scourer, CWH's scours are setup to be able to scour the full range of wool types which merchants want to have scoured including, Black, Merino, ½ Breed, Dag Wool, and all cross-bred types of wool.
  - (b) While NZWSI operates two businesses, the relevant business for the purposes of this application is its wool scours at Whakatu and Kaputone. NZWSI's scour line is set up to scour the particular types of wool NZWSI typically supplies to its export customers (such as long runs of easy scouring types such as Fleece Wool and Slipe Wool) rather than being set up so as to scour that broad range of wool types for which other merchants require scouring services. For example, CWH understands that poorer style wools such as dag wool do not perform well on NZWSI's Kaputone scour.

- (c) Lanolin Trading is a co-operative, involved as agent for its shareholders in the purchase and marketing of raw wool grease, a by-product of wool scouring. Raw wool grease is refined by customers for use in a number of applications.
- (d) Cavalier Group owns 100% of Elco Direct which operates as a wool buyer in the North Island, while NZWSI owns 50% of RWL which also operates as a wool buyer in the North Island.

## 9. New Zealand's wool scouring industry

- 9.1 Following the significant rationalisation of the wool scouring industry described in Question 5 above, New Zealand's wool scouring industry now comprises CWH and NZWSI which provide wool scouring services to a small number of wool merchants and the three domestic carpet makers (Cavalier Bremworth, Norman Ellison Carpets and Godfrey Hirst), and other further processors (e.g., apparel manufacturers).
- 9.2 The continued migration of New Zealand's apparel industry means that the majority of wool merchants' sales are export sales. In fact, around 85% of New Zealand's wool production is exported.
- 9.3 Wool that is not scoured in New Zealand is generally sent to a wool dump prior to it being shipped overseas to an end user for scouring and further processing.
- 9.4 Merchants contract with end users to provide them with clean (i.e., scoured wool). A customer will generally specify to a merchant the parameters the customer requires in order to manufacture its product range depending on the end product the customer wants to produce.
- 9.5 The merchant's job is to deliver to that specification. To do so, a merchant must determine the mix of greasy wool it needs to procure and then to engage a wool scourer to scour the wool. The merchant's margin reflects the difference between the price it pays for greasy wool and the clean wool price it has negotiated with a customer less the scouring costs it incurs.
- 9.6 As the Commission has previously recognised, this margin is very small and a merchant has the strong incentive to minimise the costs it incurs, namely:
- (a) the cost of greasy wool; and
  - (b) the scouring costs associated with cleaning that greasy wool.
- 9.7 Merchants operate globally with agents in most, if not all, of the world's major wool producing countries. Because wool is (largely) a commodity product, New Zealand greasy wool competes with greasy wools grown in other countries. New Zealand grows around 8% of the world's greasy wools, with the largest producers being Australia (20%) and China (19%)<sup>15</sup>. If the total cost of procuring greasy wool in New Zealand is too expensive, a merchant can substitute wools acquired from another country provided it can meet its customer's specifications.
- 9.8 Scouring services add to a merchant's costs of goods sold and the merchant has an incentive to reduce those. A merchant has the ability to export greasy wool and have that wool scoured offshore instead of using a New Zealand scourer. The fact that a material

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<sup>15</sup> IWTO Market Information 2010, Table 2, pg 6.

proportion – 25%<sup>16</sup> – of New Zealand's wool is exported in greasy form indicates that merchants routinely substitute offshore scouring services for those provided by CWH or simply export greasy wool.

## 10. Recent trends in wool scouring

See response to Question 5 above.

## 11. Recent consolidation in the industry

11.1 The Commission considered the wool scouring market in March 2009 when it granted clearance for a series of transactions, the net effect of which was to combine the wool scouring assets of CWH and Godfrey Hirst, and to result in CWH and Godfrey Hirst no longer being independent wool scouring competitors.

11.2 The Applicant is not aware of any other relevant transactions, although for completeness notes that in December 2010, Direct Capital acquired NZ Woolscourers Limited and thereby a 25% interest in CWH.

## Part 3: Market Definition

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### 12. Relevant markets

#### Wool scouring

12.1 The Commission defined the relevant markets in which scouring services are provided in March 2009 (Decision 666) as being:

- (a) the North Island market for the supply of wool scouring services (the **North Island scouring market**);
- (b) the South Island market for the supply of wool scouring services (the **South Island scouring market**);
- (c) the national market for the purchase and supply of wool grease (the **national wool grease market**).

12.2 The Applicant is content to adopt these markets for the purposes of this application.

12.3 In Decision 666, the Commission concluded that the competition issues in respect of the supply of wool scouring services were generic to both the North and South Island geographic markets and therefore treated them together for the purpose of the competition analysis. The Applicant takes the same approach in this application.

#### Wool procurement

12.4 As set out at paragraph 4.3 above, post acquisition it does not intend to remain the owner of the wool exporting/merchant business. However, pending such an outcome, the acquisition may lead to some transitory aggregation in the market for the procurement of greasy wool via the Cavalier Group's position as an acquirer of greasy wool (including through its ownership of Elco Direct) and NZWSI's position as an acquirer of greasy wool (including through its 50% interest in RWL).

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<sup>16</sup> Wool Exports July to June 2009-2010 (table 6.1), Beef and Lamb New Zealand, available at <http://www.meatnz.co.nz>. Of this 25%, 88% of greasy wool exports are to China and 8% are to the EU (mainly Germany and Italy).

- 12.5 In Decision 533 (PGG-Wrightson) the Commission defined a national market for wool handling services (the **wool handling market**) in which wool brokers, merchants, exporters and direct buyers competed.
- 12.6 There are a large number of participants in this market, and the extent of any transitory aggregation is limited and will fall within safe harbours given the market will inevitably be un-concentrated. For the year to 30 June 2010, CWH estimates that:
- (a) approximately 187,450 greasy tonnes were brought and sold in this market;
  - (b) the Cavalier Group acquired approximately [ ] greasy tonnes or [ ]% of total purchases (Cavalier Carpets [ ] greasy tonnes and Elco Direct [ ] greasy tonnes for external customers); and
  - (c) NZWSI acquired approximately 42,000 greasy tonnes or 22% of total purchases.
- 12.7 Given the transitory nature of any aggregation and the fact the aggregation will be within safe harbours, it is not considered further in this application. Further information can be provided if required.

### **13. Proposed acquisition reduces vertical integration**

- 13.1 The proposed acquisition will, ultimately, reduce vertical integration as NZWSI's wool scouring and wool exporting business will ultimately be separated as a result of the proposed acquisition.

## **Part 4: Counterfactual**

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### **14. Relevant counterfactuals**

- 14.1 With or without the proposed acquisition, there will be a change in the majority ownership of NZWSI. Accordingly, there are a range of counterfactuals that may eventuate depending on who the alternative buyer of the wool scour assets is.
- 14.2 For the purposes of this application, the primary question is what will happen to NZWSI's wool scouring assets. While a new majority shareholder may continue to operate the wool scour operations as they are operated currently, alternatively an overseas person may acquire control of the assets with a view to ultimately relocating those scour lines offshore.
- 14.3 CWH notes that Chinese wool scourers have become aggressive in the purchase of wool scouring assets. As described above, over recent years, many Australian scours have closed and the surplus plant has been acquired by Chinese wool scourers and relocated to China.
- 14.4 Nevertheless, the Applicant has presented its competition analysis and net benefit analysis on the basis that the relevant counterfactual is the status quo.
- 14.5 In the event that the Commission was to consider that the exit of NZWSI's wool scouring assets from New Zealand was the likely counterfactual, then the proposed acquisition would result in no detriment and should be cleared.

## Part 5: Competition Analysis

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### 15. Existing Competition

#### Nature of wool scouring – a volume driven industry

- 15.1 In Decision 666 the Commission recognised that wool scouring is an industry in which participants have an incentive to seek additional volumes so as to increase capacity utilisation and decrease costs.
- 15.2 CWH's ability and incentive to increase prices both today and post acquisition needs to be viewed in this context; an increase in price may result in reductions in volumes lost to competing suppliers.
- 15.3 NERA has undertaken a critical loss analysis to assess CWH's incentives to increase prices post acquisition. NERA's analysis is fully described at Section 2 of their report. The analysis was based on CWH estimates of gross margin and [ ]
- ] Those
- customers represent approximately [ ]% of post merger volume in the North Island and [ ]% in the South Island.
- 15.4 NERA's analysis indicates:
- (a) CWH would have to lose only [ ]% or [ ] million kgs of its North Island volume to make a 5% price increase in the North Island unprofitable; and
- (b) CWH would have to lose only [ ]% or [ ] million kgs of its South Island volume to make a 5% price increase in the South Island unprofitable.
- 15.5 To put those volumes in context:
- (a) in the North Island, [ ] of CWH's clients scour more than the critical loss level by themselves ([ ])) while another [ ] clients scour between [ ] and [ ] million kgs per year ([ ]); and
- (b) in the South Island, [ ] of CWH's clients scour more than the critical loss level by themselves ([ ]).
- 15.6 This analysis suggests that the loss of only one customer, or alternatively the loss of a relatively small amount of volume from a range of these customers, will have a material impact on CWH's profitability.

#### Domestic competition today

- 15.7 There are currently two providers of commission wool scouring services in New Zealand: CWH and NZWSI. In Decision 666, the Commission concluded that although NZWSI at that time had a limited involvement in commission scouring and was mostly involved with scouring for its own wool purchase/export business, it had sufficient incentives to develop its wool scouring operations to improve profitability. This was particularly because via the CWH/Godfrey Hirst acquisition:
- (a) NZWSI would acquire ex-Godfrey Hirst equipment; and



- (b) CWH would enter in an agreement with NZWSI whereby Cavalier Wool would underwrite a minimum increase (40,000 bales) in NZWSI's commission scouring volumes, subject to certain terms and conditions being met.
- 15.8 The underwriting agreement required NZWSI to use "all reasonable commercial endeavours" to obtain new commission scouring customers, which the Commission considered "would require it to set its scouring prices at levels that would induce switching of customers from [CWH]".<sup>17</sup> Overall, the Commission concluded that NZWSI would provide "some degree of competitive constraint".<sup>18</sup> CWH agrees with the Commission's conclusions, given the state of the market at that time. CWH informed the Commission during that investigation that:
- (a) wool merchants tend to spread their wool scouring requirements across competing scourers to maintain the ability to switch and the threat to switch; and
- (b) merchants faced with a price increase would be incentivised to consider and test their options given their relatively small margins.
- 15.9 CWH considers that the existence of alternative scouring options remains important and something which merchants both seek to develop and utilise to protect them should CWH seek to increase prices.
- 15.10 However, a merchant's options are not limited to existing participants. In Decision 666 the Commission concluded (correctly) that merchants (either individually or collectively) would have the incentive to either sponsor entry, or to enter themselves if they faced a price increase of 5-10%.<sup>19</sup> Such a move would result in a permanent loss of business for CWH, which would have major impacts on CWH's ongoing profitability as shown by NERA's critical loss analysis. The Commission recognised this in Decision 666 concluding that "[g]iven the importance to CWH that it maintains high capacity utilisation, even the threat of entry may be sufficient to constrain the combined entity"<sup>20</sup> and, hence, that *de novo* new entry would satisfy the LET test.
- 15.11 It remains the case that given the critical importance of volume efficiencies, any threat by merchants to CWH that they would move some of their scouring business to another scourer (wherever located) or commence their own operations is a potent threat.
- 15.12 CWH's experience since Decision 666 is it is the threat and the option for merchants to use Chinese scours to scour wool or the ability for them to establish their own scour operations which have constrained prices, rather than the presence of NZWSI.
- 15.13 Having said that, CWH acknowledges that NZWSI's scouring revenues (as disclosed in its financial statements) appear to have increased. However, CWH has been unable to reconcile these numbers with its own experience of the market. For example, the NZWSI numbers imply an average scouring tariff 88% higher than CWH's average scouring tariff.
- 15.14 CWH believes NZWSI may have increased the volume it scours for its existing customers, but does not believe NZWSI has captured as much new business as it had anticipated when it acquired the former Godfrey Hirst plant. In fact, CWH's underwriting agreement with NZWSI guaranteed NZWSI 40,000 bales from new customers. NZWSI has made a claim under that agreement for [ ] bales indicating that it has attracted [ ] of the guaranteed minimum volume.

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<sup>17</sup> Decision 666, para 133.

<sup>18</sup> Decision 666, para 140.

<sup>19</sup> Decision 666, para 173.

<sup>20</sup> Decision 666, para 174.

- 15.15 That is not to say that NZWSI would not provide the constraint the Commission (and CWH) considered it *could* if the ability to export greasy wool to China was not available. However, the reality is that with the growth of the Chinese scouring industry and the imperative for CWH to seek to compete with Chinese scouring tariffs to remain competitive, these are the primary constraining factors facing CWH today.
- 15.16 CWH continues to understand that some merchants have been reluctant to use NZWSI as a commission scourer because NZWSI also competes with those merchants in export markets. There appears to be a perception that the NZWSI scour lines are configured to achieve the best result from the wools generally scoured by NZWSI with the result that those scours are less able to cope with other wool types which other merchants acquire. CWH also understands that most merchants are concerned about supplying information to a competitor on the types and quantities of wools they are buying and the specifications they are supplying.

### **Constraint from overseas wool scourers**

- 15.17 As already described, around 85% of New Zealand's wool is exported. Merchants can export wool to supply their customers overseas in either clean (i.e., scoured) or greasy form. If merchants are required to deliver a clean product to an offshore merchant, then they may acquire scouring services outside New Zealand.
- 15.18 Accordingly, CWH competes every day with wool scourers in offshore markets to provide scouring services. The constraint imposed by offshore providers of scouring services is particularly evident in relation to China.

#### **A. 21% of wool exports (18% of New Zealand's wool clip) are already scoured in China**

- 15.19 As described above, China:
- (a) is the largest manufacturer of textiles and clothing in the world accounting for nearly one third of the world's raw wool used for processing and manufacturing;
  - (b) is the second largest grower of wool;
  - (c) is the largest importer of wool in the world accounting for 49% of the world's wool imports, with its share of the world's imports having grown from 3% in 1990 (reflecting an increase in imports from 35,000 tonnes in 1990 to 305,377 tonnes in 2009).

- 15.20 While China's broader wool industry has grown, correspondingly, other major manufacturers have retrenched with imports by Western European countries (Italy, Belgium, Germany, France, Denmark, Spain and Portugal (together)) fell from 373,287 tonnes in 1990 to 98,287 tonnes in 2009, which represents a 73.7% fall. Similarly imports into the US fell from 41,271 tonnes in 1990 to 4,953 tonnes over the same period<sup>21</sup>.
- 15.21 China is New Zealand's most important wool export market. In the 12 months to June 2010, 38% of New Zealand's wool exports were sent to China; nearly 57% of those exports are in greasy form.<sup>22</sup> In other words, today, 21% of New Zealand's wool is being scoured in China, which indicates the extent of competition CWH faces from Chinese scourers.

**B. Chinese wool scouring is economic for New Zealand wools**

- 15.22 This degree of scouring of New Zealand wool in China is unsurprising given the large Chinese customer base and the fact that Chinese wool scourers are extremely cost competitive.
- 15.23 In Decision 666 the Commission's calculations showed that scouring wool in China can be less costly than scouring wool in New Zealand by approximately 5 cents/kg. CWH has updated that analysis.
- 15.24 This cost advantage arises because Chinese scourers operate with cheaper labour, lower effluent management controls and now have an industry scale that is highly efficient in grease extraction. Since 2009, tariffs have decreased further and with the appreciation of the New Zealand dollar means that Chinese scourers are even more price competitive today than they were in 2009.

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<sup>21</sup> The next largest importer of raw wool is India with 10%. IWTO Market Information 2010, Table 22, pg 27.

<sup>22</sup> In the 12 months to June 2010, 46,282 tonnes of wool (greasy, scoured and slipe (clean equivalent)) were exported to China. New Zealand's total exports of all wool (greasy, scoured and slipe) were 122,893 tonnes. Greasy wool comprised 26,384 tonnes (clean equivalent) of the 46,282 tonnes (clean equivalent) exported to China. Wool Exports July to June 2009-2010 (Table 6.1), Beef + Lamb New Zealand, available at <http://www.meatnz.co.nz/main.cfm?id=259>.

15.25 Using the approach accepted by the Commission in Decision 666, CWH estimates that scouring wool in China can be less costly than scouring wool in New Zealand by approximately 10-13 cents/kg.

Comparative costs of wool scouring for exports destined for China (cost in cents, per greasy kg)	New Zealand	China
<b>Scouring tariffs</b>		
– New Zealand average net <sup>23</sup> trade tariff [ ]	[ ]	
– Tariff in China – US\$0.08-0.10 per kg at 0.75 NZ/US \$ exchange rate <sup>24</sup>		10.6-13.3
<b>Pressing (required for export of clean product)</b>		
– Dense packed at [ ]c clean (base on 75% yield)	[ ]	
– Normal (not dense) included in scour tariff		0
<b>Freight</b>		
– US\$1,000 for a 20 ft container which can accommodate 20,400kg of clean wool or 27,200kg greasy wool (based on 75% yield)	4.9	5.9
– 0.75 exchange rate		
<b>Dumping</b>		
– Prices range up to \$13.5/bale, 165 greasy kg/bale – maximum price used		8.1
	[ ]	<b>24.6-27.3</b>

15.26 Furthermore, since 2009, the Chinese Government has made changes to the VAT applied to imported wools which have the effect of making scouring greasy wool in China more cost competitive. Currently, a 17% VAT charge applies to imported clean wools while only 13% is applied for greasy wools. This serves to exacerbate the price advantage enjoyed by Chinese wool scourers.

**C. Chinese wool scouring is of commercially acceptable quality**

15.27 CWH acknowledges that various parties have, in the past, expressed concerns with the quality of the services offered by Chinese wool scourers and issues associated with time delays and logistical problems.

15.28 Nevertheless, any issues which may exist have not been sufficient to outweigh the commercial advantage of having wool scoured in China particularly given the growing end use demand in China. This is evidenced by the fact that two thirds of all New Zealand wool destined for China and 21% of all New Zealand’s wool exports are exported greasy i.e., are scoured by Chinese scourers.

<sup>23</sup> Net tariff reflects [ ]

<sup>24</sup> The existing spot rate is 0.77, although it has average 0.75 over the past quarter. Published forecasts are for the exchange rate to sit in the 0.78-0.80 range in 2011 before returning to a 0.75 level in 2012.

**D. No barriers to expansion – Chinese wool scouring industry is expanding**

15.29 The Chinese scouring industry has been rapidly expanding and its capacity to grow is almost unlimited. Based on its own market intelligence, CWH understands that there are over 100 scour lines in China. Some of major scours in China CWH understands to be of international standards are:

- (a) Fine Wool Spinning Factory of Jiangsu Group;
- (b) Hebei Diamond Cashmere Products;
- (c) Inner Mongolia Muwang Co;
- (d) Reward Ningbo Wool Industry;
- (e) Zhejiang Xinao Textiles Group;
- (f) Charguers;
- (g) Schneider;
- (h) JingAo Scour Company (Jiang Su);
- (i) ZhongAo Top Company (trade free zone Zhang Jia Gang); and
- (j) Tianyu Wool Industry Co, Zhangjiagang.

15.30 CWH understands that the top 18 scour lines in China have a combined capacity of 375,000 tonnes, which is almost twice New Zealand's approximately 200,000 tonne capacity.

15.31 The expansion of the industry is exemplified by the fact that recently, Chinese interests have acquired the wool scouring plant which has become available due to scouring plant closures in Australia and Germany. A further example is Tianyu's recent move to install three 3.0 metre "Top Master" scour lines. The capacity of this plant in itself exceeds the capacity in the North Island post acquisition.

15.32 Recent closures of scours in Australia, a larger exporter of wool than New Zealand, reflect the expansion and constraint imposed by Chinese wool scourers. This is illustrated by the following comments from the Managing Director of Jandakot Wool Washing Pty Limited made in January 2009 when announcing the cessation of Jandakot's wool scouring operations in Western Australia:

It has been become increasingly apparent that as China, Australia's biggest wool trading partner, increases its market dominance and their continued reluctance to purchase processed wool has resulted in wool processing in Australia diminishing each year. The processing of scoured wool in Australia has declined every year for the last 8 years which has resulted in a significant over capacity of wool scouring equipment in Australia. This combined with the large decline in off farm wool production has made our scouring business in Western Australia unsustainable and as a result has forced us to take this unfortunate decision.

**E. Chinese scouring does and will constrain CWH**

15.33 A merchant's ability to utilise, or threaten to utilise, Chinese wool scourers provides a compelling constraint on CWH's scouring tariffs.

***Merchants have a presence in China***

- 15.34 The majority of CWH's customers are active in the Chinese market, with the following maintaining offices in China:
- (a) Chargeurs Wool Trading Corporation, (Shanghai);
  - (b) H Dawson Sons & Co (Wool) Ltd;
  - (c) Elders Ltd, Shanghai, (Owners of JS Brooksbanks);
  - (d) Lempriere Australia, (Shanghai);
  - (e) Michell, (Jiangsu);
  - (f) G Modiano Ltd, (Shanghai);
  - (g) Standard Wool, (Nanjing); and
  - (h) Schneider.
- 15.35 All of these firms operate internationally and most have offices in several countries around the world. With established Chinese operations, these customers can readily access Chinese scour operators and, indeed, Chargeurs and Schneider have their own scours in China which they control.

***Any loss of volume tends to be permanent***

- 15.36 As already discussed, the profitability of wool scourers is highly sensitive to volume loss. NERA's critical loss analysis indicates that it would take very little diversion of demand to make a price increase unprofitable.
- 15.37 This is a dynamic constraint because CWH's ability to "win back" volume lost to China is difficult given the cost advantages that a merchant can extract and the permanent move of the world's wool processing base to China.

***Constraint extends beyond just clean wool destined for China***

- 15.38 CWH does not agree with the view expressed by the Commission in Decision 666 (para 180) that the constraint imposed by Chinese scourers is limited to only the clean wool currently scoured in New Zealand which is subsequently exported to China.
- 15.39 For its part, CWH has certainly not given up on attracting some of the greasy wool exports back to be scoured in its plants and has every incentive to pursue that volume. It is incorrect to presume it is turning a blind eye to this lost volume.
- 15.40 The Commission's view implies that CWH will have the ability to discriminate its scouring tariffs depending on whether a customer presents a consignment destined for China as compared to some other destination.
- 15.41 Market practice is for a merchant and CWH to establish standard scouring tariffs and rebates and terms of supply periodically. These standard terms are then applied for any volumes of

greasy wool that merchant decides to have scoured by CWH. Furthermore, CWH has limited visibility over the ultimate destination of wool prior to accepting a consignment.<sup>25</sup>

- 15.42 It follows that when setting the scouring tariff/terms of supply, CWH has no way of knowing whether a customer will utilise CWH to scour wool that is ultimately destined for China or wool that is ultimately destined for another market. Since it cannot determine the destination prior to setting price, its ability to price discriminate is negligible to the point of being non-existent. Accordingly, the latent threat of a merchant scouring greasy wool in China instead of with CWH is a real constraint regardless of its ultimate destination particularly given the benefit to CWH of securing additional volumes.<sup>26</sup>
- 15.43 Importantly, the commercial and market place reality is that CWH's relationship with its merchant customers does not consist of a series of one-off negotiations whereby each party seeks to secure the best deal for each particular consignment of wool ignoring the longer term relationship implications.
- 15.44 To illustrate, CWH is and must be mindful of the ramifications of increasing prices to a customer for a consignment of wool for which Chinese scouring is not a viable alternative. Increasing the price for that consignment may result in that merchant retaliating by:
- (a) shifting other wool consignments away from CWH;
  - (b) substituting overseas greasy wool for New Zealand wool in situations where the final destination is not China; or
  - (c) either alone, or together with other merchants, sponsoring the entry of a new scourer into New Zealand.
- 15.45 Over the medium term, any of these outcomes will exacerbate the competitive threats faced by CWH and expose it to further volumes losses and diseconomies of scale. As NERA's critical loss analysis indicates, it would not take a large loss of supply for a price increase to be unprofitable. Even if the Commission was of the view that constraint was limited to clean wool destined for China, approximately 15% of New Zealand's wool exports (or 13% of the wool clip) are currently exported in clean form to China and hence the prospect of losing a proportion of this volume would materially constrain CWH.

## 16. Potential Competition

- 16.1 In Decision 666 the Commission concluded that *de novo* new entry into the North Island and South Island scouring markets "would be likely, sufficient in extent and timely" in the event the merged entity sought to increase prices by 5% to 10%.
- 16.2 The Applicant agrees with this conclusion, which is just as valid in early 2011 as it was in early 2009. Nothing has changed in the market which should cause the Commission to revisit this conclusion.
- 16.3 Given the likelihood of constraining entry, the Commission was of the view that potential entry would provide some constraint. In the Applicant's view, this likelihood of entry will be sufficient in itself to constrain the Applicant particularly, as the Commission accepted, it is important that CWH maintains high capacity utilisation.

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<sup>25</sup> [

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<sup>26</sup> In any event, given the scouring cost advantages enjoyed by Chinese mills the potential exists for merchants to export greasy wool to China for scouring and then re-export to customers in Europe and other markets.

## 17. Countervailing Power of Buyers

- 17.1 In Decision 666 the Commission concluded that merchants were likely “to continue to exercise significant countervailing power” due to the “presence of NZWSI, the possibility of scouring some wool offshore, and the threat of entry” and merchants’ continued “ability to switch, or to credibly threaten to switch.”<sup>27</sup>
- 17.2 For the reasons explained above, CWH still regards merchants and other customers as having material countervailing power. While NZWSI will no longer be an independent option, the other options available to merchants will be sufficient to prevent any attempt by CWH to increase prices above competitive levels.

## Part 6: Public Benefits and Detriments

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### 18. Benefits to the public

#### Summary of benefits to the public

- 18.1 The acquisition will result in such material and demonstrable benefits to the public that it should be permitted.
- 18.2 The benefits identified by CWH constitute benefits that have been previously recognised by the Commission to constitute public benefits. Where relevant, they have been assessed using approaches previously endorsed by the Commission.
- 18.3 As described in response to Question 5, the primary commercial benefits arise from the consolidation of CWH’s and NZWSI’s scouring lines from five sites to three sites generating cost savings and improved economies of scale and enabling the Whakatu and Kaputone sites to be released for other uses.
- 18.4 CWH has every incentive to pursue these efficiency gains because they will enable CWH to offer a lower cost, higher quality scouring service, thereby improving CWH’s ability to compete more effectively with Chinese scourers.
- 18.5 The public benefits largely mirror these commercial benefits although additional benefits will flow as a by-product of the capital works required to consolidate the wool scours. The capital changes will enable CWH to provide a higher quality scouring service to merchants which will be of benefit to them. In turn this can be expected to increase demand for CWH’s scouring services (all else being equal) creating further commercial benefits for CWH.
- 18.6 There are also benefits which will arise which cannot be readily quantified but are no less important and should be considered in the Commission’s assessment.
- 18.7 None of the benefits can arise in the counterfactual.

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<sup>27</sup> Decision 666, para 194.



- 18.8 Each element of public benefit is discussed in detail below, but the public benefits are summarised below:

	Per year (excluding one-offs)	5 year NPV
<b>Total benefits</b>	[ ]	<b>\$40.84 million to \$82.09 million</b>
• Non capital cost savings (economies of scale benefits, rationalisation of overheads / labour costs etc)	[ ] million	\$( [ ] ) million
• Sales of surplus land and buildings (one-off)		\$( [ ] ) million
• Capital expenditure savings	[ ] million	\$0.88 million
• Quality improvement (range based on demand elasticity of -0.5 to -3)	\$( [ ] ) million to \$( [ ] ) million	\$( [ ] ) million to \$( [ ] ) million
• One off rationalisation costs		\$( [ ] ) million

### Operating (non-capital) costs savings – economies of scale benefits

CWH will realise industry cost savings of \$( [ ] ) million per year or \$( [ ] ) million over five years as a result of consolidating the wool scours. This equates to [ ] cents per greasy kg processed.

- 18.9 The wool scouring business is driven by economies of scale with major benefits accruing to firms best able to utilise capacity.
- 18.10 The Commission accepted this in Decision 666 when the Commission examined the cost efficiencies associated with increases in capacity utilisation. CWH provided evidence to the Commission which showed that for HBWS, an increase from 60% to 80% capacity utilisation would reduce costs (including depreciation but excluding interest) per kilogram of greasy wool processed by around [ ] cents per kilogram or [ ]%. Similarly for CWH, the same figures were [ ] cents per kilogram or [ ]%. The Commission noted that other industry participants submitted similar numbers.

#### A. Rationalisation of plant

- 18.11 The acquisition will enable CWH to achieve increased economies of scale by rationalising the five plants currently operated by CWH and NZWSI to two. This will enable it to reduce both the operating and overhead costs associated with operating the scours. This reduction in operating costs per unit will enable CWH to more effectively compete to provide scouring services for the gradually reducing New Zealand wool clip.
- 18.12 As outlined above in response to Question 5, following the acquisition CWH will:
- (a) relocate the NZWSI 3 metre scour line currently located at Whakatu to its Awatoto plant;

- (b) relocate NZWSI's 3 metre scour line at Kaputone to CWH's existing site at Timaru;
- (c) close CWH's scour line at Clive in the Hawkes Bay – this is currently used to cover emergencies and peaks in demand. This will no longer be needed post acquisition; and
- (d) close CWH's 2.4 metre scour line at Timaru, which it will replace with the NZWSI 3 metre scour line.

#### **B. CWH will retain sufficient capacity to meet demand**

- 18.13 Despite this removal of capacity, based on current production figures (and estimated production figures for NZWSI), the modifications CWH make to the remaining scour lines will retain around 16.7% spare capacity in the North Island and 21.6% spare capacity in the South Island.<sup>28</sup> Given the benefits to be gained from increased production, it will have every incentive to seek to utilise this capacity to the fullest extent possible.
- 18.14 The modifications are described in detail above in response to Question 5.

#### **C. Total non-capital savings attributable to the transaction**

- 18.15 CWH has estimated the cost savings that arise as being \$[ ] per year or \$[ ] million over five years. This equates to [ ] cents per kilogram of greasy wool processed.
- 18.16 This estimate is based on the level of production remaining largely unchanged as between the factual and the counterfactual. In reality, the reduction in costs resulting from the merger is likely to allow CWH to compete more strongly to recapture some of the volume it has lost to China such that volumes are more likely to be higher in the factual than the counterfactual.
- 18.17 The types of cost savings claimed are of the same type as those accepted by the Commission in Decision 410. In that case, the Commission accepted that cost savings would be likely to arise from:
- (a) removal of duplication of event management and maintenance equipment; and
  - (b) savings in administration expenses such as insurance, reduction in management and director expenses, and other overhead costs.
- 18.18 The major areas in which costs are forecast to be saved are:
- (a) [ ] cents per greasy kilogram reduction in industry operating expenditure, representing a saving of \$[ ] million per year; and
  - (b) [ ] cents per greasy kilogram reduction in administration expenditure representing a saving of \$[ ] million per year. The major component of this is a reduction in [ ].
- 18.19 This is a significant saving given the small margins enjoyed in this industry. As the Commission noted in Decision 666, merchants' margins sit around 7 cents per kilogram.

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<sup>28</sup> This is based on the budgeted increase in the Whakatu line to [ ] greasy kgs per hour. If, as management expect, throughput increases to a greater amount, then the level of excess capacity would increase.

## Sale of surplus land

The proposed acquisition enables the release of the Whakatu and Kaputone sites for other uses. Applying the Commission's previous approach, this will result in a benefit of \$[ ] million.

- 18.20 Following the restructuring described above, NZWSI's sites at Whakatu and Kaputone and CWH's Clive site will be surplus to requirements. CWH will sell the Whakatu and Kaputone sites. It has yet to determine whether it will sell the Clive site.
- 18.21 In Decision 410, the Commission accepted as a benefit cost savings associated with the rationalisation of the merger parties' off-mountain maintenance bases. The Commission accepted a figure of \$140,000 arising from the disposal of one maintenance base based on "the Government Valuation of the capital and land value of one of the RAL properties in National Park".
- 18.22 Applying the same principles, the benefit resulting from the transaction would be \$[ ] million based on Government Valuations, recent sales in the area and market intelligence.

## Capital cost savings

The acquisition will reduce capital costs by \$0.88 million over a five year period.

- 18.23 CWH spends approximately \$[ ] million on capital projects at each of its sites for both winter maintenance and improvements in productivity/efficiencies. There is no reason to change in the counterfactual.
- 18.24 CWH estimates that NZWSI's capital expenditure reflects about 75% of the CWH level given NZWSI's smaller operation.
- 18.25 Accordingly, combined capital expenditure across the two businesses would be approximately \$[ ] million per year.
- 18.26 CWH believes its current maintenance programme has sufficient capacity to encompass maintenance for the NZWSI scour lines (particularly given the closure of the Timaru 2.4 metre scour line). Accordingly, CWH believes its maintenance costs would not increase post acquisition and it would avoid expenditure currently incurred by NZWSI on winter maintenance and improvements in productivity/efficiencies. Accordingly, this would result in a cost saving of \$[ ] per year.
- 18.27 However, as described above, CWH will undertake capital works on its Awatoto and Timaru plants in order to move the NZWSI scour lines to those plants. CWH estimates the total capital outlay will be around \$[ ] million. This amounts to \$[ ] million of additional expenditure compared to the counterfactual. This additional expenditure has been incorporated in the estimates of capital cost savings as an increase in capital costs in the factual in year 1.

## Improvements in scouring product quality

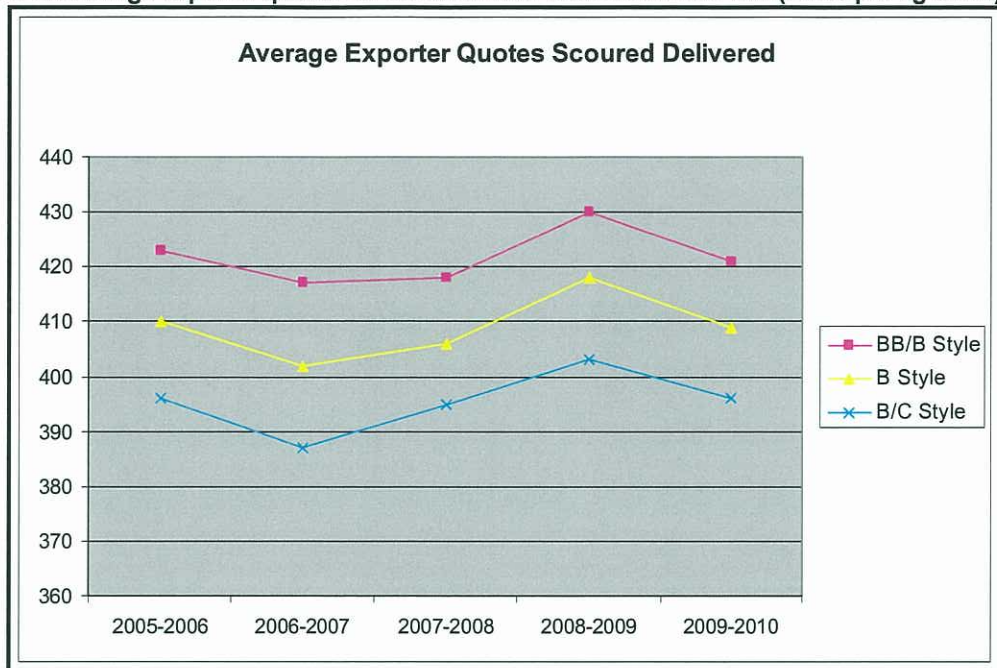
Restructuring of the scour lines will increase the quality of wool scouring services provided. The benefit to New Zealand using the Commission's settled approach to estimating dynamic efficiency gains/losses is \$[ ] million to [ ] million per year.

- 18.28 The restructuring of CWH's post acquisition scour assets described above will not only generate direct incremental benefit for CWH through cost savings and other efficiencies but it will also have a direct flow on benefit for merchants.
- 18.29 These will arise because CWH's planned scour line modifications will improve the quality of the scouring service CWH will provide to merchants. Put simply, after these modifications merchants using CWH will be able to deliver the same quality (whiteness and brightness) of clean wool to their customers utilising a lower quality mix of greasy wool.
- 18.30 Because greasy wool that is whiter and brighter is more expensive to procure, merchants will be able to lower the level of the mix of their greasy wool input quality thereby enabling them to achieve cost savings.

### A. Whiteness and brightness of wool is an important determinant of wool value

- 18.31 The degree of yellowness and of whiteness or brightness of the wool affects the value that end use customers place on wool. Primarily this is because it is impossible to dye wool lighter than its original colour, i.e., if a customer wants to produce a woollen product in a light pastel colour, it needs the clean wool it acquires to be as white and bright as possible. In short, whiter and brighter wool can be used in a greater range of applications.
- 18.32 Wool colour is objectively assessed by the X, Y and Z tri-stimulus values:
- (a) The Y value indicates the whiteness and brightness of the wool, with a higher Y value indicating a better colour.
  - (b) Y-Z indicates how yellow the wool is, with a lower Y-Z value indicating less yellow wool.
- 18.33 These values are measured according to internationally agreed standards developed and ratified by the International Wool Textile Organisation (IWTO).<sup>29</sup>
- 18.34 The value placed on whiter and brighter wool can be seen in the price of clean wool delivered to the mill. Figure 2 below shows the average prices for clean and delivered wool quoted by exporters to mills over the 2005/6 to 2009/10 seasons. The three series are for identical lengths, strengths, micron and vegetable matter. The only difference is the "Style", with the differences in Style being primarily related to colour, with BB/B being the whitest and B/C being the least white of these three Styles.
- 18.35 Figure 2 illustrates what mills are prepared to pay as a differential between these three Styles. Prices range (using the last point) from a BB/B of \$4.21 to a B/C of \$3.96, a price variance of \$0.25.

<sup>29</sup> IWTO is the international body representing the interests of the world's wool-textile trade and industry. IWTO membership covers woolgrowers, traders, primary processors, spinners, weavers, garment makers and retailers of wool and allied fibres in its member-countries, as well as all kind of organisations related to wool products and the wool business in general. See: [www.iwto.org](http://www.iwto.org).

Figure 3: Average exporter quotes for scoured wool delivered to the mill (cents per kg clean)<sup>30</sup>

18.36 A number of empirical studies have addressed the question (among other things) of the extent to which buyers pay a higher price for wool which is whiter and brighter wool, i.e., has a higher Y value. These studies are discussed in Section 4.3 of NERA's Report. In summary:

- (a) A 1994 report prepared by Dr D C Maddever for the Wool Research Organisation of New Zealand Inc<sup>31</sup> indicated that every one unit of Y had a value of 5.9 cents per clean wool kilogram.<sup>32</sup> Based on an average price per kg of clean wool in the 1992/93 growing season (the season from which the auction data was sourced) of \$4.33, this implied that every one unit had a value of approximately 1.36%. AgResearch Ltd<sup>33</sup> has commented as recently as May 2010 that "it is reasonable to expect that Maddever's results remain relevant today because the spinners' requirements for good-colour wools have not changed in the interim".<sup>34</sup>
- (b) Sumner, McDermott and Cox (2008) using data from 2003 to 2007 estimate a price premium for a unit increase in the Y value of strong wool of 2.5 cents per clean kilogram.<sup>35</sup>

<sup>30</sup> Source: CWH.

<sup>31</sup> D C Maddever (1994), "Analysis of NZWB Wool Auction Data 1992/93", *WRONZ Confidential Report No. CFR 94/007*. A copy is attached.

<sup>32</sup> Data for the 1984-93 period showed an increase in Y value of wool would increase its price by 6.2 cents per clean kg.

<sup>33</sup> AgResearch is New Zealand's largest Crown Research Institute. Its two shareholders are the Minister of Finance and the Minister of Crown Research Institutes. It states that its mission is to "create sustainable wealth in New Zealand's pastoral and technology sectors through focusing science and technology on 2020 Science encompassing the dairy, meat and textile industries, the biophysical environment, the relationship between agriculture and society, and the necessary, underpinning biotechnologies". See: [www.agresearch.co.nz/default.aspx](http://www.agresearch.co.nz/default.aspx).

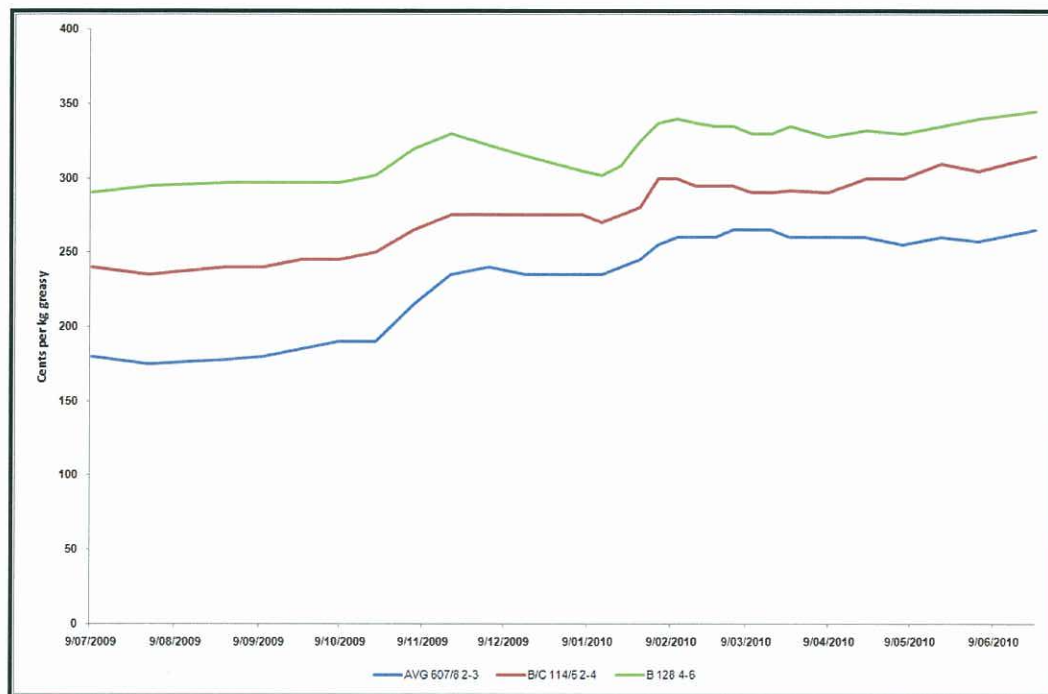
<sup>34</sup> Ranford S, Wood E "Wool Colour Specification", AgResearch Limited (May 2010).

<sup>35</sup> R.M.W Sumner, A.K. McDermott and N. R. Cox (2008), "Relative Economic Value of Wool Processing Parameters for New Zealand Strong Wool Between 2003 and 2007", *Proceedings of the New Zealand Society of Animal Production*, 68, 53-56.

- (c) Aryal et al (2009) estimate a price premium for a unit increase in the Y value of 3.52 cents per clean kilogram,<sup>36</sup> although it is not known the years from which their data is drawn.

18.37 Analysis of greasy wool auction prices for the Napier auctions in the 2009 to 2010 season is consistent with the conclusion that an important determinant of wool prices is colour. Figure 3 shows actual prices (in cents per kg greasy) per type for the sale of B Style, B/C Style and C Style wool. As a rule of thumb the industry works on the basis that a B Style has a Y value of approximately 64 (regarded as white wool with no real permanent yellow colour), a B/C Style has a Y value of approximately 62 (wool with some yellow in it, that cannot be dyed white) and a C Style (being AVG 607/8 2-3) has a Y value of approximately 60 (yellow wool with permanent stain).

Figure 4: Average greasy wool auction prices by type – Napier auctions 2009-2010<sup>37</sup>



## B. How greasy wool's Y value can improve during the scouring process

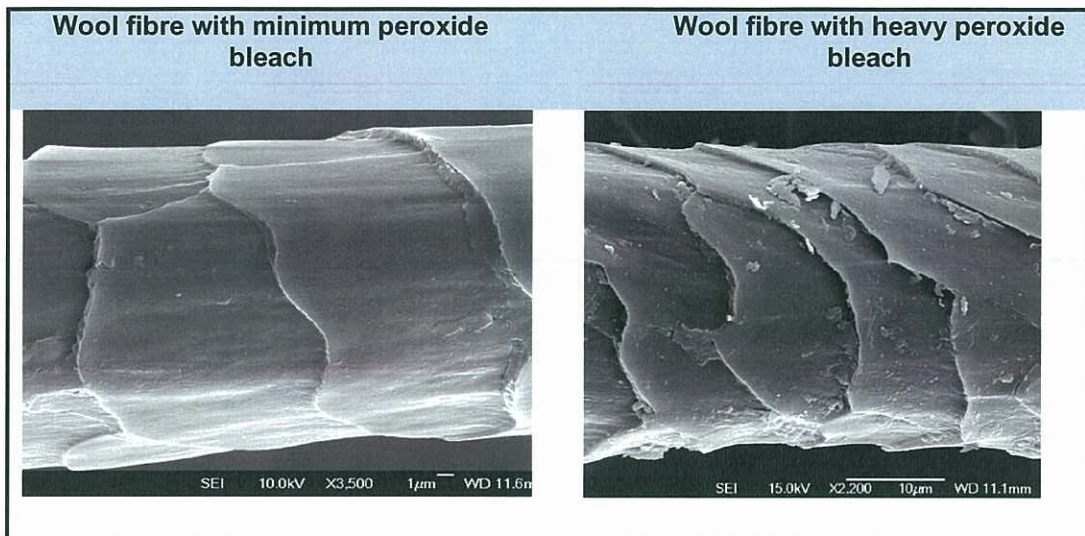
18.38 Traditionally, the only way the Y value of greasy wool could increase during the scouring process was if it was whitened using peroxide bleach. However, adding bleach imposes two other costs:

- (a) The first cost is the cost of the bleach itself.
- (b) Secondly, bleaching wool breaks down the wool fibres as illustrated in Figure 4 which shows the degradation in the wool fibre as a result of the heavy use of peroxide bleach.

<sup>36</sup> J. Aryal, D. Kulasiri, G.A. Carnaby, and S. Samarsinghe (2009), "Investigating the Price of the New Zealand Wool Clip Using Modelling Approaches", Paper presented at the 18<sup>th</sup> World IMACS/MODSIM Congress, Cairns, Australia, 13-17 July.

<sup>37</sup> Source: CWH.

Figure 5



The degradation of the wool fibre means that bleached wool is less robust than wool that has not been bleached. The outcome is that bleached wool results in greater processing losses for customers than unbleached wool. For that reason, many customers do not prefer bleached wool. Cavalier Bremworth, for example, refuses to allow other than a non-detectable amount of bleach to be used on its wools.

18.39 While, traditionally, adding peroxide has been the only way in which the Y value of greasy wool could be improved through scouring, CWH has modified its scouring lines in a way which has resulted in CWH being able to improve the Y value of greasy wool it scours without adding bleach.

18.40 While it has made modifications in both the North and South Islands, those modifications differ slightly as explained below.

**C. CWH's North Island modifications and the resulting quality improvements – "Y benefit"**

18.41 In the North Island, over the past 10 years CWH has increased the throughput of its Awatoto scour lines to achieve greater economies of scale. It did this by increasing the number of openers on the scour line well above the industry norm, making major modifications to bowl number one so as to increase the turnover of cleaning liquid, adding a high jet spray rinse and adding dirt loops.

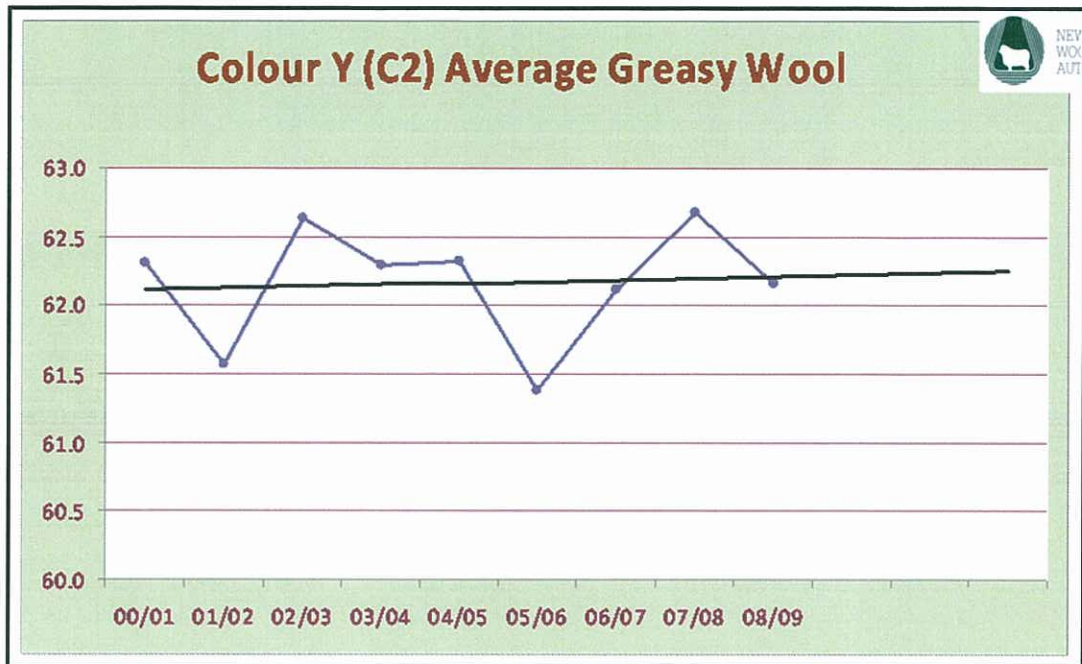
18.42 This had the anticipated effect on volumes as wool which has been opened more can be scoured more quickly. Indeed, over the past 10 years, CWH has increased the run-rate from its Awatoto scours from [ ] greasy kgs per hour to [ ] greasy kgs per available hour, an increase of close to [ ]%.

18.43 Furthermore, the ancillary benefit was that the clean wool produced on this modified plant was whiter and brighter – i.e., it had a higher Y value – than was previously the case. This is because a by-product of wool being opened to a greater extent prior to scouring is that a greater proportion of the wool fibres can be scoured.

18.44 The quality improvements generated by CWH's modifications are illustrated in Figures 5 to 7 below.

- (a) Figure 5 shows the average Y value of greasy wool scoured in the North Island over the past decade.<sup>38</sup> This illustrates that over the last 10 years, the average Y value of greasy wool used in the North Island has remained relatively static; the average Y value of greasy wool has increased only marginally from an average of 62.1 in the 2000/01 growing season to an average of 62.3 in the 2008/09 growing season. While Figure 5 is not CWH specific, because the greasy wool supplied to CWH is selected by merchants, CWH believes the North Island statistics reflect the average quality of greasy wool being provided to CWH over this period.

Figure 6: North Island greasy wool – Y value



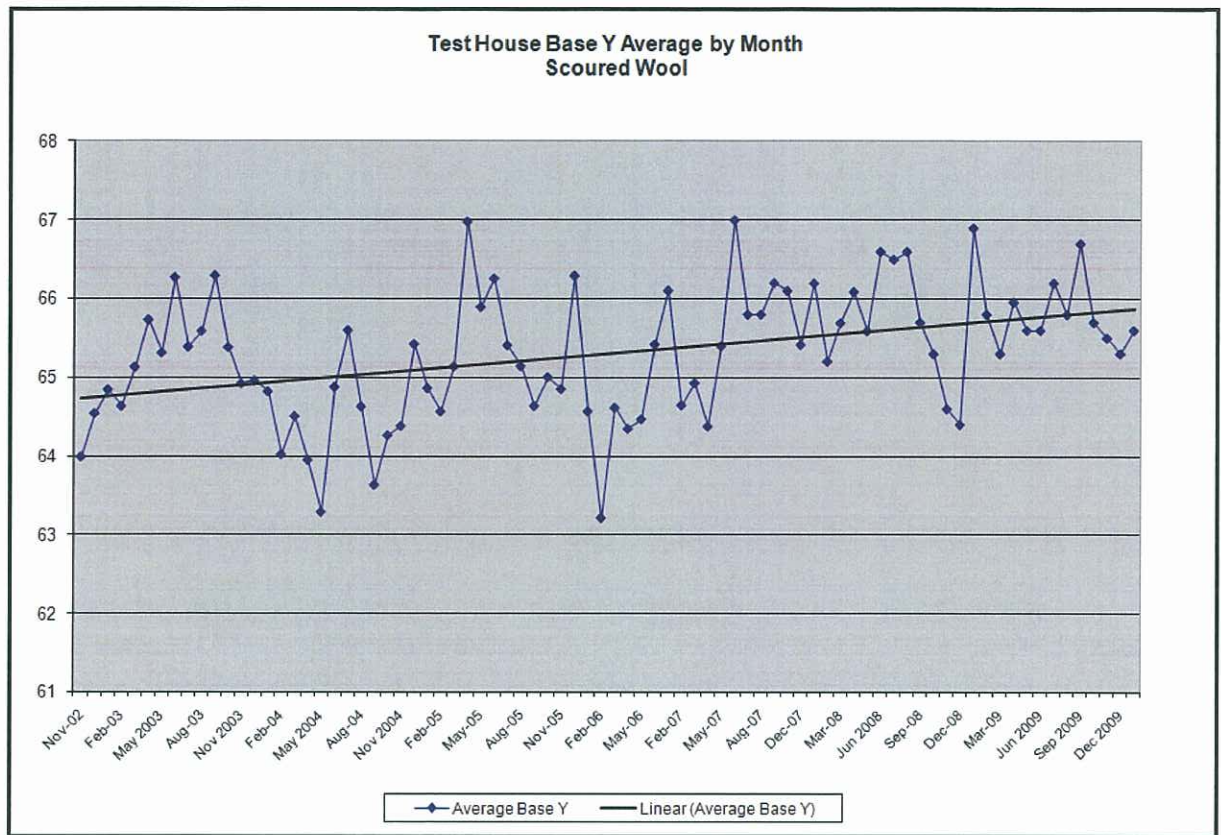
- (b) Figure 6 below shows the average Y value of the clean wool coming off CWH's Awatoto scour lines wool over the same 10 year period.<sup>39</sup> This shows that the Y value of clean wool has increased over the same period by approximately one unit from 64.8 to 65.9.
- (c) Figures 5 and 6 combined illustrate that the Y value of clean wool coming off CWH's scour lines wool has increased despite the Y value of the greasy wool remaining static.

<sup>38</sup> The data is sourced from the North Island Greasy Wool Statistics produced by the New Zealand Wool Testing Authority, which has historically tested the majority of New Zealand's wool.

<sup>39</sup> The data represents 1.9 million bales washed, and 7,000 individual data points.



Figure 7: CWH scoured wool volumes – Y value



(d) Figure 7 below illustrates that this improvement has not been generated by the use of peroxide bleach. Figure 7 shows CWH's use of peroxide (on a litres per tonne of wool scoured basis) has remained static (at worst) or even declined over the same 10 year period.

Figure 8: CWH peroxide use per tonne of wool

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18.45 Accordingly, the modifications CWH has made to its Awatoto scours have increased the Y value of the clean wool coming off its scours by 1 Y unit for any given mix of greasy wool supplied to it by a merchant.

**D. South Island modifications**

- 18.46 CWH installed a new 3.0 metre line at its Timaru plant in 2005. CWH configured that plant not only to meet the specifications it has developed on its Awatoto scour lines (which had delivered the quality improvements described) but made further modifications and refinements (added additional openers, bowls and washers to the scour line) so as to improve throughput further.
- 18.47 These additional modifications were possible in Timaru because the site was unconstrained – the current configuration of the Awatoto buildings (but not the area of the site) has prevented similar additional modifications being made in the North Island.
- 18.48 These modifications in Timaru further increased the Y value of the clean wool coming off this scour line for any given mix of greasy wool supplied to it by a merchant.
- 18.49 Unlike the North Island, data on greasy wool Y values is not available for the South Island. Because CWH scours a wide range of wool types including cross-bred merino, mid micron and other fibres, the comparison made between wool Y values and CWH's clean wool Y values is not as accurate as it is in the North Island.
- 18.50 However, while similar data to the North Island does not exist for the South Island over the ten year period, CWH receives consistent feedback from merchants that the Timaru modifications have generated an additional "Y benefit" for merchants. Support for this statement is available from merchants.

**E. The benefit to the merchant**

- 18.51 A customer will generally specify to a merchant the parameters the customer requires in order to manufacture its product range, including a certain whiteness and brightness specification (i.e., the Y and Y-Z values of wool) depending on the end product the customer wants to produce.
- 18.52 The merchant's job is to deliver to that specification. To do so, a merchant must determine the mix of greasy wool it needs to procure and send to a scourer in order to produce the required clean wool specification.
- 18.53 Given the merchant's margin is the difference between the price it pays for greasy wool and the clean wool price it has negotiated with a customer less the scouring costs it incurs, a merchant has the incentive not only to minimise its scouring cost but also to minimise the cost of the greasy wool it uses to produce any customer specified wool output.
- 18.54 A merchant can minimise its greasy wool costs by manipulating the quality mix of the greasy wool it uses to meet a customer's specified clean wool specification. The customer is indifferent as to the colour of the greasy wool used provided that the clean wool product meets its required specification.
- 18.55 For example, if a customer specifies that it wants a clean wool colour of 65 Y, a merchant may be able to use a mix of greasy wools with colours of 63, 64 and 67 Y, but still be able to meet the 65 Y clean wool specification in which case the customer will be indifferent.
- 18.56 The benefit to the merchant is the ability to use a cheaper mix of greasy wool to achieve the same quality outcome, or alternatively use the same mix of wool to achieve a better quality output. While in aggregate the Y value of greasy wool is determined by the wool growers and environmental conditions, the ability to change the mix of greasy wool being used (i.e., substituting wool which has a lower Y value) will enable merchants to increase the average Y value of clean wool sold and/or provide them with a greater ability to increase the spread between the cost of the greasy wool input and the clean wool price they can obtain.

18.57 Either way, over time this enables merchants to compete more effectively in the international wool market to supply customers.

18.58 While difficult to isolate, CWH understands that merchants have responded to the improved scouring service it has offered in exactly this way, i.e., by adjusting the blend of greasy wool they use so as to minimise their costs while still being able to meet their customer's specifications.

**F. The benefit to CWH**

18.59 The first order benefit for CWH, as a commission wool scourer, is that the modifications drive greater throughput and economies of scale. This reduces costs per unit and therefore increases margins.

18.60 Furthermore, there is a second order benefit to CWH which arises over the medium to long term. Attracting volume requires CWH to demonstrate that it provides a better quality scoured wool product. Providing a Y benefit enables merchants to achieve "the same for less" in terms of Y value and greasy wool input costs. This assists CWH in attracting this greater volume and thereby leads to increased throughput and reduced variable costs.

**G. Additional quality benefits from the acquisition**

18.61 The modifications CWH will make to the scour lines post acquisition are fully described in response to Question 5. While CWH's incentive to implement these modifications is to increase the throughput and efficiency of the scour lines, the modifications will result in CWH delivering a higher quality scouring service to merchants by delivering additional "Y benefits".

18.62 In other words, compared to the counterfactual, in the factual a merchant will be able to deliver to a customer's specification using a greasy wool mix with a lower Y value. This will arise in two ways:

***Quality benefit 1: Modifying the WSI scour lines***

18.63 Given the quality improvements CWH has realised (as described above), CWH expects the modifications it will make to the NZWSI scour lines – which are of the same type as those made to its CWH scour lines to date – will have the same quality impact, i.e., the whiteness of the clean wool coming off the NZWSI scour lines will be higher post transaction than it was pre-transaction given any mix of greasy wool impact and level of bleach used.

18.64 Put another way, as a result it can be expected that merchants will be able to decrease the Y value of the greasy wool mix they use to produce any desired clean colour output.

18.65 CWH estimates that approximately [ ] bales per year of greasy wool are currently processed on the Whakatu and Kaputone scour lines.

***Quality benefit 2: Further improvements to the Awatoto scour lines***

18.66 The second benefit accrues from the further modifications CWH will make to its Awatoto plant post transaction to align the specification of the three Awatoto scour lines to CWH's Timaru 3.0 meter scour line. CWH's experience with its recent changes at Timaru is described above and CWH believes the further modifications will deliver a further throughput and quality benefit.

18.67 Given the physical constraints of the Awatoto building, CWH can not currently make these changes to its existing Awatoto scour lines – they are developed to the fullest extent possible.

Based on its experience at Timaru, CWH believes the run rate of these scour lines will increase and, as a by-product, the Y value of clean wool will increase by at least 1 unit given the mix of greasy wool and level of bleach used.

- 18.68 As with Y benefit 1, the increase means that merchants will be able to decrease the greasy wool mix to produce any desired clean colour output.

#### **H. Value to merchants**

- 18.69 CWH have asked NERA to estimate the benefits to merchants from the increases in quality and NERA's analysis is set out in detail in Section 2.3 of their report.
- 18.70 NERA's analysis is calibrated to reflect the different estimates of the price premium buyers attach to whiter and brighter wool. They have estimated the benefit based on a minimum value rise of 2.5 cents per clean kg and a maximum value increase of 6.2 cents per clean kg, which is equivalent to a range of 1.9 cents per greasy kg and 4.7 cents per greasy kg.
- 18.71 NERA quantify the benefits in the scouring market – conceptually, this reflects the benefit of the increased product quality that CWH can provide post transaction reflected in an increase in demand for their scouring services above what it would otherwise be. That is, in the presence of these quality benefits the merchant would be willing to pay CWH up to the premiums they attach to whiter wool (i.e., 1.9 to 4.7 cents per greasy kg).
- 18.72 NERA explain that the model they have used is the same as used by the Commission previously to estimate dynamic inefficiency losses except that demand increases, rather than decreases. To be conservative, NERA have also allowed for an increase in price which is normally expected to result from an increase in demand.

#### ***Quantification of quality benefit 1***

- 18.73 NERA have estimated the benefits associated with the improvements that will be made to the NZWSI scour lines to bring them up to CWH standard to be in the order of \$[ ] million to \$[ ] million per year or \$[ ] million to \$[ ] million over five years in NPV terms.

#### ***Quantification of quality benefit 2***

- 18.74 NERA have estimated the benefits associated with further improvements to CWH's Awatoto scour lines and the Whakatu scour line to be in the order of \$[ ] million to \$[ ] million per year or \$[ ] million to \$[ ] million over five years in NPV terms.

#### **Other unquantified benefits**

- 18.75 There are a range of other benefits CWH considers are likely to arise as a result of the acquisition and which are not achievable in the counterfactual. They are benefits which should form part of the Commission's weighting of the benefits and detriments.
- 18.76 These have not been quantified either because it is impractical to do so, or because quantification was not possible prior to this application being submitted. Further information on those benefits will be provided.

#### **A. Enhancing New Zealand's scouring industry**

- 18.77 The acquisition will act to fortify and enhance New Zealand's wool scouring industry, an industry which employs 170 FTEs and contributes approximately \$60 million to the New Zealand economy.
- 18.78 New Zealand is not immune to the trends sweeping the scouring world and associated with an aggressively expanding Chinese wool scouring industry. These trends have already seen

the Australian, French, Italian and British wool scouring industries retrench to a point where they are competitively marginalised.

18.79 Indeed, while Australia produces significantly more wool than New Zealand it now has virtually no domestic scouring industry.

18.80 While enhancing CWH's ability to compete, the acquisition will also ensure that NZWSI's scouring assets are kept in New Zealand. Many of the Australian scours which have closed have been acquired by Chinese wool scourers and relocated to China. There is every reason to believe that this could occur if the acquisition does not proceed.

#### **B. 'Wool super store' benefits**

18.81 Greasy wool that is to be scoured needs to be stored prior to scouring. Currently, brokers operate their own collection and storage facilities. Wool is then transported to the wool scours.

18.82 A 'wool super store' refers to the concept of centralised consolidation at purpose built independent greasy wool super stores sited adjacent to one or more wool scours. Wool sorting, classing, testing and storage would occur under one roof, which would lead to the elimination of the duplication of resources currently present in the wool industry.

18.83 A wool super store would streamline the process by which wool is currently being aggregated in New Zealand and lead to a more efficient and shortened pipeline for getting wool from the farm gate to scour and then to market.

18.84 This benefit will only arise in the factual because CWH has no incentive to develop this model absent this acquisition.

### **19. Public detriments**

#### **Proposed acquisition will generate negligible detriments**

19.1 Given the constraints imposed by the continued growth of the Chinese wool scouring industry, CWH believes that the proposed acquisition would result in little, if any, public detriment.

19.2 Nevertheless, CWH recognises that the proposed acquisition will reduce the number of New Zealand based wool scourers from two to one and has therefore assessed the level of detriment which could be said to arise if the loss of NZWSI as a competitive constraint was considered to be significant.

- 19.3 Accordingly, CWH engaged NERA to estimate the detriments that would be said to arise using the Commission's previous approach if the acquisition was considered likely to reduce the competitive constraints faced by CWH. The analysis is discussed in detail below, but the estimates of detriments using the approaches adopted by the Commission in previous authorisation decisions are summarised in the table below:

	Per year	5 year NPV
<b>Total detriments</b>	<b>\$0.72 million to \$9.04 million</b>	<b>\$3.03 million to \$34.58 million</b>
• Loss of allocative efficiency (assuming 1%-10% price increase)	\$0 million to \$3.51 million	\$0 to \$14.77 million
• Loss of productive efficiency (range of 1% to 5% increase in costs compared to counterfactual)	[\$ ] million to [\$ ] million	[\$ ] million to [\$ ] million
• Loss of dynamic efficiency (multiplying total revenue by a factor 0.5%-1.5% and moving the demand curve by 0.5%-1.5%)	[\$ ] million to [\$ ] million	[\$ ] million to [\$ ] million

### Loss of allocative efficiency

- 19.4 Allocative inefficiencies depend on the extent to which a merged entity will increase prices and the sensitivity of demand to increases in price (i.e., the level of demand elasticity).
- 19.5 For the reasons discussed above and in light of NERA's critical loss analysis, CWH's view is that it will have no greater ability or incentive to increase prices in the factual as compared to the counterfactual.
- 19.6 Nevertheless, CWH has asked NERA to estimate the allocative efficiency detriments that might arise from the acquisition if the Commission took the view that CWH would have both the ability and incentive to increase prices post acquisition.
- 19.7 A full description of NERA's analysis is provided at Section 3.3 of their report. In summary, NERA has utilised the conceptual framework developed by the Commission in previous authorisation applications and has utilised that model to estimate allocative efficiency losses detriments across a range of demand elasticities and price increases.<sup>40</sup>
- 19.8 The estimates are based on data supplied by CWH. The model requires data on an industry wide basis. However, CWH does not have direct access to NZWSI's price and cost data and therefore where NERA has not been able to source non-CWH data from other sources, it has used CWH data as a proxy for overall market data. CWH management expect that CWH's data is likely to provide an adequate proxy for market wide data. It has formed this view based on the following:
- (a) discussions held from 16 January 2010 to 24 August 2010 between CWH and NZWSI directors, shareholders, managers, and legal and other advisers regarding a potential merger of CWH and NZWSI and the value attaching to the NZWSI assets;

<sup>40</sup> NERA's critical loss analysis illustrates that CWH would have no incentive to increase prices if demand elasticity was greater than [ ] (in absolute terms). Therefore, for demand elasticities greater than or equal to [ ] (in absolute terms), the allocative efficiency detriment is \$0 because CWH would not increase prices in such a scenario and so no allocative efficiency losses would accrue.

- (b) NZWSI's publically disclosed financial information;
- (c) CWH management's extensive knowledge of scouring plants, sites and costings; and
- (d) scouring industry volume, timing and market share data derived from the Lanolin Trading Company.

19.9 As with the critical loss analysis, NERA have excluded [

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19.10 NERA's analysis shows that:

- (a) *even if CWH was able to profitably increase prices by 5% above competitive levels, the resulting loss in allocative efficiency would range from approximately \$0.85 million to \$1.69 million per year; and*
- (b) *in a more commercially realistic (although still commercially unlikely) price increase of 1% above competitive levels, a loss in allocative efficiency would range from approximately \$0.16 million to \$0.33 million per year.<sup>41</sup>*

### Loss of productive efficiency

- 19.11 The acquisition would result in a loss in productive efficiency if CWH had less incentive in the factual compared to the counterfactual to minimise its costs of production.
- 19.12 Typically, a 2-to-1 merger would be considered to yield productive efficiency losses as it is presumed that a monopoly producer lacks the competitive pressure to produce products and services for the lowest cost.
- 19.13 However, a finding that CWH's incentives to produce at the lowest cost will be lower in the factual compared to the counterfactual requires a conclusion that it is the presence of NZWSI that provides an incremental impetus for CWH to minimise costs.
- 19.14 It is true that CWH will be the only wool scourer in New Zealand post transaction. Nevertheless, CWH not be able to act as a monopoly supplier of wool scouring services given the ability for merchants to acquire wool scouring services from offshore producers in China, a constraint that is fully described in response to Question 15.
- 19.15 The only way in which CWH can continue to offer sustainably competitive scouring services is to seek to minimise its own cost base. Any tendency to let costs increase will simply result in CWH becoming less price competitive and ceding further volume to Chinese producers.
- 19.16 Given the importance of volume in driving down costs per unit, any loss of volume due to productive inefficiency would be compounded through a loss of economies of scale thereby creating a vicious cycle in which CWH's cost competitiveness would be eroded. Accordingly, there appears little incentive for CWH to allow its vigilance in keeping costs low to slacken.
- 19.17 It is the competitive constraint arising from China coupled with the importance of increasing volume and throughput so as to drive profitability that today provides the impetus for CWH to seek out greater efficiencies in production and to lower costs. These primary constraints will continue with or without the acquisition. The presence or absence of NZWSI provides no (or

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<sup>41</sup> In the extreme scenario where CWH is assumed to be able to increase scouring prices by 10% above competitive levels, NERA estimates a loss in allocative efficiency ranging from approximately \$1.66 million to \$3.32 million per year.

an imperceptible) additional incentive to minimise production costs and therefore there will be no productive efficiency losses from the acquisition.

- 19.18 Nevertheless, CWH acknowledges that the Commission has previously taken the view that the presence of a single New Zealand provider may cause productive efficiency losses. While CWH does not agree any such losses will arise in this case, CWH has asked NERA to estimate what the extent of any loss of productive efficiency might be using the approach used by Commission in its previous authorisation decisions. A full description of NERA's analysis is provided at Section 3.4 of their report.
- 19.19 The Commission's previous approach involves applying a factor of between 1%-10% to the pre-merger variable costs so as to provide a proxy for increases in costs. Using that approach, even if CWH faced lower incentives to minimise costs (which is denied), NERA estimates that productive efficiency losses using this approach would be \$[ ] million per year based on a 1% increase in costs and to \$[ ] million per year based on a 5% increase in costs.<sup>42</sup>
- 19.20 For the reasons explained above, CWH believes that even a 1% increase in costs above counterfactual levels is highly unlikely to occur and therefore represents a very conservative measure of the likely detriments from the acquisition.

### Loss of dynamic efficiency

- 19.21 The acquisition would result in a loss in dynamic efficiency if CWH had a lesser incentive in the factual than in the counterfactual to engage in product and process innovation.
- 19.22 As illustrated in the public benefits section, CWH has a demonstrated history of delivering process and service improvements to the benefit of the industry. NZWSI's presence has not driven this behaviour, but rather it has been driven by the nature of the industry and the global competition it faces. Accordingly, CWH believes it will face the same incentives to be productively efficient with or without the acquisition, and it believes it will face the same incentives to continue to seek out process and product innovation.
- 19.23 Nevertheless, as with productive efficiency losses, CWH acknowledges that the Commission has previously taken the view that the presence of a single New Zealand provider may cause dynamic efficiency losses. While CWH does not agree any such losses will arise in this case, CWH has asked NERA to estimate what the extent of any loss of dynamic efficiency might be using the approach used by Commission in its previous authorisation decisions. A full description of NERA's analysis is provided at Section 3.5 of their report.
- 19.24 NERA explain in their report that in the *Air New Zealand / Qantas* case the Commission calculated the loss in general dynamic efficiency by multiplying total revenue by a factor of 0.5%-1.5%. Using this approach NERA estimate a loss of dynamic efficiency of \$[ ] million to \$[ ] million per year.<sup>43</sup>

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<sup>42</sup> In the extreme (and highly unlikely) scenario where costs increased by 10%, the loss would be \$[ ] million per year.

<sup>43</sup> The Commission's view is that its approach captures losses due to a firm having less incentive to (a) create new products and (b) seek new and cheaper methods of production. However, to be conservative NERA tested their results by estimating dynamic efficiency losses separately for each of (a) and (b). A full discussion of their analysis is at Section 3.5 of their report.

The results depend on assumed reductions in demand due to there being fewer product innovations in the factual compared to the counterfactual.



## Part 7: Other information

### 20. Other interested parties

Please provide the contact details of likely interested parties, such as customers and suppliers, and any other relevant market participants, in the form of the example table shown below:

Name of interested party	Contact details	Contact person
<b>Carpet Manufacturers</b>		
Godfrey Hirst NZ Limited	142 Kerrs Road Wiri +64 9 268 3300 www.godfreyhirst.co.nz	Tanya Pauling
Cavalier Bremworth Limited	7 Grayson Avenue Papatoetoe PO Box 97040 Auckland www.cavbrem.co.nz	Colin McKenzie
<b>Wool Merchants</b>		
Segard Masurel (NZ) Ltd	Level 9, PSIS House 20 Ballance Street Wellington Central P O Box 3473 +64 4 472 3596	Peter Whiteman, Managing Director
JS Brooksbank & Co Ltd	47 Haining Street Te Aro Wellington P O Box 704 +64 4 385 1055	Andrew Campbell, General Manager
Fuhrmann NZ Ltd/Waihi Wools (1981) NZ	75 Peterborough Street Christchurch P O Box 1164 +64 3 379 6173	John Henderson
John Marshall & Company/Otago Wool Exports Ltd	63 Mandeville Street Christchurch P O Box 8332 +64 3 341 2004 www.joma.co.nz	Peter Crone, Managing Director
Standard Wool NZ	Unit 5, 422 Innes Road Mairehau Christchurch P O Box 1814 +64 3 385 3956	Glenys Finlinson
H Dawson & Sons Co NZ Ltd	PO Box 25303 Christchurch 8144 +03 366 6917 www.hdawson.co.nz	Mark Johnstone
Bloch & Behrens Wool (NZ) Ltd	PO Box 9024 Christchurch 8149 +03 339 4670 www.blochwool.com	Palle Petersen

Name of interested party	Contact details	Contact person
J L Crichton & Co Ltd	PO Box 1916 Christchurch 8140 +03 366 0389	Colin White, Managing Director
Schneider New Zealand Ltd	PO Box 8929 Riccarton Christchurch 8440 +03 379 5241 www.gschneider.com	Helen Cameron
Marquet Trading Ltd	12 Aranui Rd Mt Wellington Auckland +09 574 5080	Steve Major
Textile Wools Ltd	Essentially Building Level 2 2 Heather St Parnell Auckland +09 921 4253	Dean Hegan
Rokelay Wool NZ Ltd	66 Edmund St Kohimarama Auckland +09 575 8360	Alan Robertson
<b>Wool Associations</b>		
New Zealand Council of Wool Exporters	425 Churchill Street Richmond Christchurch City Canterbury 8013 +64 3 353 1049 www.woolexport.net	Nick Nicholson
Beef + Lamb New Zealand	Level 4 Wellington Chambers 154 Featherston Street Wellington www.meatnz.co.nz	Scott Champion
New Zealand Council of Wool Interests	Unit 9, Amuri Business Park 404 Barbados Street Christchurch +64 3 353 1049	Stephen Fookes
New Zealand Federation of Wool Merchants	PO Box 113 Drury 2247 + 64 9 294 9017	Shaun Ryan
Minister's Wool Group	First Floor, 17 Shea Terrace Takapuna 0722 Auckland New Zealand + 64 9 489 4060	Colin Harvey
Merino New Zealand	Level 6, 97 Cambridge Terrace Christchurch 8144 +64 3 377 7990	John Brackenridge

## 21. Confidentiality

- 21.1 Confidentiality is not claimed for the fact of the transaction.
- 21.2 The Applicant claims confidentiality for this Application pursuant to section 9(2)(b) of the Official Information Act 1982. A Public Version will be provided separately which will identify confidential information by enclosing it in bold square brackets (i.e., [  ]) (the **Confidential Information**). The Confidential Information is commercially sensitive and valuable information which is confidential to the Applicant (vis-a-vis the public), and disclosure would be likely to unreasonably prejudice the commercial position of the Applicant.
- 21.3 The Applicant requests it be notified of any request made under the Official Information Act for release of the Confidential Information, and that the Commission seeks their views as to whether the Confidential Information remains confidential and commercially sensitive at the time responses to such requests are being considered.

## Annexure A: Declaration

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THIS NOTICE is given by Cavalier Wool Holdings Limited

Cavalier Wool Holdings Limited hereby confirm(s) that:

- all information specified by the Commission has been supplied;
- if information has not been supplied, reasons have been included as to why the information has not been supplied;
- all information known to the applicant(s) which is relevant to the consideration of this application/notice has been supplied; and
- all information supplied is correct as at the date of this application/notice.

Cavalier Wool Holdings Limited undertake(s) to advise the Commission immediately of any material change in circumstances relating to the application/notice.

Dated this                    day of February 2011.

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**Nigel Ralph Hales**

I am an officer of the Cavalier Wool Holdings Limited and am duly authorised by Cavalier Wool Holdings to make this application/notice.