



COMMERCE COMMISSION

## Statement of Preliminary Issues

### New Zealand Comfort Group / Dunlop Living

13 May 2011

11.4/12829

#### INTRODUCTION

1. On 5 May 2011, the Commerce Commission (Commission) received an application from New Zealand Comfort Group Limited (New Zealand Comfort Group) seeking clearance to acquire all of the business assets of Dunlop Living Limited (Dunlop Living). The public version of the application can be accessed on the Commission's website at:

<http://www.comcom.govt.nz/assets/Uploads/New-Zealand-Comfort-Group-Limited-Dunlop-Living-Limited-Clearance-Application-5-May-2011.pdf>

2. This Statement of Preliminary Issues outlines the key competition issues the Commission currently considers will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as the Commission's assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.
3. The Commission invites interested parties to make comment on the likely competitive effects of the proposed merger.

#### RELEVANT PARTIES

##### **The Acquirer – New Zealand Comfort Group Limited**

4. New Zealand Comfort Group (formerly known as Sleepyhead Manufacturing Limited) is ultimately 100% owned by interests associated with Graeme and Craig Turner.
5. New Zealand Comfort Group's core business is the manufacture and wholesale supply of beds. It also manufactures polyurethane foam (PU foam), using a horizontal continuous slabstock manufacturing process. Most of this foam is for use in its own bed manufacturing. New Zealand Comfort Group also manufactures foam carpet underlay and latex foam.

##### **The Target – Dunlop Living Limited**

6. Dunlop Living is 70% owned by Rangatira Limited, 15% owned by interests associated with Michael Sexton, and 15% owned by the interests associated with Richard Adams.

7. Dunlop Living is a manufacturer and wholesale supplier of beds. Like New Zealand Comfort Group, it manufactures PU foam, using a horizontal continuous slabstock manufacturing process which it then uses in its own bed manufacturing. Dunlop Living also converts and supplies PU foam to competing bed and furniture manufacturers. Dunlop Living also manufactures foam carpet underlay.

## **ANALYTICAL FRAMEWORK**

8. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition. The first step of the Commission's analytical framework<sup>1</sup> is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target where aggregation of market share may arise from the proposed acquisition. The Commission then considers the relevant products and geographic regions that constitute close substitutes from both a customer's and a supplier's point of view.
9. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios:
- with the acquisition in question (the factual); and
  - in the absence of the acquisition (the counterfactual).

The impact of the acquisition on competition is then viewed as the prospective difference between those two scenarios.

10. The Commission analyses the extent of competition in each relevant market for both the factual and counterfactual scenarios, in terms of:
- existing competition - the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices;
  - potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so;
  - the countervailing market power of buyers - the potential for a business to be sufficiently constrained by purchasers' ability to exert an influence on price, quality and/or terms of supply; and
  - coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.
11. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition may lessen competition. If the lessening is substantial the Commission may not give clearance to the proposed acquisition.

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<sup>1</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

## **PRELIMINARY ISSUES**

12. The proposed acquisition would result in overlap in three product categories: PU foam, beds and carpet underlay.
13. Of the factors outlined in the previous section, the Commission considers its focus in respect of the proposed acquisition will be on the following areas:

### **Market Definition**

14. In respect of market definition, the Commission will consider:
  - the extent to which horizontal continuous slabstock PU foam is substitutable for box PU foam for use in beds and furniture applications;
  - the extent to which PU foam underlay is substitutable for rubber underlay; and
  - whether there is a single market for all box beds, or whether box bedding can be differentiated based on price and/or quality factors.

### **Existing Competition**

15. In its application, New Zealand Comfort Group states that in the underlay market the merged entity would have a market share of around 88%. However, New Zealand Comfort Group considers that it would face significant constraints, especially from imports. The Commission will test the extent to which the combined entity would be constrained by imports post acquisition.
16. New Zealand Comfort Group considers that the recent entry of Joyce Foams, an Australian PU foam producer, would continue to constrain the merged entity in respect of PU foam supply in New Zealand. The Commission proposes to assess the extent to which Joyce Foams and other PU foam imports would be likely to constrain the merged entity from exercising market power.
17. New Zealand Comfort Group states that almost all of its PU foam is for use in its own bed manufacturing. Further, that its manufacturing plant is configured to produce a relatively narrow range of mainly bedding grade PU foams. This suggests that there may be minimal change in the market situation relating to PU foam following the acquisition. The Commission will investigate the extent to which New Zealand Comfort Group is a competitive constraint in respect of PU foam.
18. In respect of beds, the Commission proposes to consider whether:
  - existing competitors such as Sealy and A H Beard would provide strong competition post acquisition; and
  - imports would constrain the merged entity from exercising market power.

### **Countervailing Power**

19. The Commission will consider whether large purchasers of PU foam, carpet underlay and bedding could credibly threaten to switch suppliers, or import directly, in order to counteract any exercise of market power by the combined entity.

### Other Competition Factors

20. Both New Zealand Comfort Group and Dunlop Living are vertically integrated in respect of PU foam, bedding and carpet underlay. The PU foam they produce is used in the manufacture of beds, and the scrap foam is used to produce underlay. The Commission will assess whether the increase in vertical integration would result in New Zealand Comfort Group being able to exert market power at any level post acquisition.
21. The acquisition would reduce the number of competitors in the PU foam market and would result in a high level of concentration. The Commission will investigate whether the acquisition would enhance the scope for market participants to coordinate behaviour.

### NEXT STEPS

22. In line with the Commission's Merger and Acquisitions Clearance Process Guidelines (available on the Commission's website at [www.comcom.govt.nz](http://www.comcom.govt.nz)), the Commission has established a draft timeframe for consideration of the issues and New Zealand Comfort Group's application for clearance. An extension of time was agreed to by the Applicant such that the Commission should make its final decision by **24 June 2011**. However, this timeframe could change. To keep abreast of possible changes in relation to timing and to find relevant documents, visit the Clearance Public Register on the Commission's website at:

<http://www.comcom.govt.nz/clearances-register/>

23. As part of its investigation, the Commission will identify the parties it believes will provide the best information to help it assess the preliminary issues identified above. The Commission will be contacting those parties over the next few weeks.
24. The Commission invites submissions from any other parties who consider they have information relevant to the Commission's consideration of this matter. If you wish to make a submission, please send it to the Registrar, at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference New Zealand Comfort Group / Dunlop Living in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by **4pm on Monday 23 May 2011**. Please clearly identify any confidential information contained in the submission and provide contact details.