

**Notice
under s66 of the
Commerce Act 1986 by**

**Cavalier Corporation Limited &
Norman Ellison Holdings Limited**

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

8 October 2007

By email: registrar@comcom.govt.nz

The Registrar
Market Structure Group
Commerce Commission
PO Box 2351
WELLINGTON

CAVALIER CORPORATION LIMITED & NORMAN ELLISON HOLDINGS LIMITED

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

SUMMARY

1. Cavalier Corporation Limited or an interconnected body corporate of Cavalier Corporation Limited ("**Cavalier**") and Norman Ellison Holdings Limited ("**NEHL**"), on behalf of the shareholders in NEHL ("**NE Shareholders**") seek clearance for a proposal under which:
 - (a) A new joint venture company (owned by the parties) will acquire the carpet business of NEHL and subsidiaries ("**Norman Ellison**"); and
 - (b) The NE Shareholders acquire shares in Cavalier,on the basis outlined in this application.
2. The proposed acquisition ("**Proposal**") will result in aggregation in the market for the manufacture/import and wholesale supply of carpet in New Zealand. The Commission recently examined this market when it granted clearance for Godfrey Hirst NZ Limited to acquire Feltex Carpets Limited (*Decision No. 587, 31 August 2006*).

Rationale

3. The market for the manufacture/import and wholesale supply of carpet in New Zealand is highly competitive. The enlarged Godfrey Hirst/Feltex, the surplus manufacturing capacity on both sides of the Tasman and the increasing presence of imports, have added, and will continue to add, to the competitive pressures experienced by the market participants.
4. Due to these increasing competitive pressures, Cavalier has been investigating ways in which it can achieve greater efficiencies and therefore lower costs to better compete in the market. The purchasing of a majority stake in Norman Ellison's business will assist Cavalier with achieving these greater efficiencies, and developing a better trans-Tasman "footprint".

5. At the same time, the shareholders in Norman Ellison have been considering succession issues and looking at efficiency improvements and financial support. As a result, the shareholders of Norman Ellison are willing sellers.

Affected markets

6. In Decision No. 587, the Commission considered the relevant markets to be:
 - (a) the North Island market for the supply of wool scouring services; and
 - (b) the national market for the manufacture/import and wholesale supply of carpet ("**national carpet market**").
7. Norman Ellison does not currently supply wool scouring services. The Proposal will therefore only result in aggregation in the national carpet market.

No substantial lessening of competition

8. The Proposal will not result in a substantial lessening of competition in the national carpet market.
9. The national carpet market is highly competitive and will remain highly competitive post-acquisition due to:
 - (a) **The continued presence of Godfrey Hirst/Feltex as the largest market player with an extremely strong trans-Tasman presence.** Godfrey Hirst acquired Feltex late last year. As a result of that acquisition, Godfrey Hirst/Feltex is the largest participant in the national carpet market and is significantly larger than Cavalier, the second largest market participant. In fact, Godfrey Hirst/Feltex is so dominant in the national carpet market that the combined Cavalier/Norman Ellison will still be smaller post-acquisition. This Godfrey/Feltex dominance is exacerbated by its position across the Tasman where it accounts for around [] of the Australian carpet market.
 - (b) **The continued and likely increasing presence of imports.** Currently, around 21% of the national carpet market is made up of imported product, with more than 70% of that coming from Australia. Imports are comparable in both price and quality to locally produced products. They already provide a significant constraint on market participants and will continue to do so post-acquisition. In fact, offshore producers benefit from significant economics of scale simply because of the much larger markets offshore (eg. the Australian market is approximately five times the size of the New Zealand market). Transport costs across the Tasman are relatively low (generally around 2% of the CIF price) and shipping times are quick (4 days across the Tasman and between 14 and 30 days further a field). As the Commission has previously noted, the incidence of imports is expected to increase, assisted by the nil import tariffs for Australia and the continuing reduction in import tariffs for other countries.
 - (c) **The continued presence of smaller/niche players who could readily expand.**
 - (d) **Relatively low barriers to entry.** The threat of potential competition will continue to provide a constraint post-acquisition.
 - (e) **The countervailing power exercised by retailers and others.** The retail network, and in particular the large retailers, have significant countervailing power. Large retailers can, and do, switch quickly between domestic suppliers

and imports in response to increases in prices and/or changes in service levels or quality. This ability of large retailers to switch between suppliers, locally or overseas, will continue post-acquisition. Advisory groups, such as architects, specifiers and interior designers, also have considerable countervailing power and will also continue to constrain the parties post-merger.

- (f) **Substitutes.** There is, and always will be, a material level of competition from outside the national carpet market because of the number of alternatives to carpet as a flooring option (eg. wood, ceramic tiles, vinyl and concrete).

PART I: TRANSACTION DETAILS

1. What is the business acquisition for which **clearance** is sought?

1.1 Cavalier Corporation Limited, or an interconnected body corporate of Cavalier Corporation Limited ("**Cavalier**"), and Norman Ellison Holdings Limited ("**NEHL**") on behalf of the shareholders in NEHL ("**NE Shareholders**") seek clearance for a proposal under which:

- (a) a new joint venture company (to be owned 70/30 by the parties) will acquire 100% of the business assets of NEHL, Norman Ellison Carpets Limited ("**NECL**"), Horizon Yarns Limited ("**HYL**"), NEC Manufacturing Limited ("**NECML**"), Carpet Distributors Limited ("**CDL**") and Norman Ellison Carpets Pty Limited ("**NECPL**"), (together, the "**Norman Ellison business**" or "**Norman Ellison**"); and
- (b) the NE Shareholders acquire a stake in Cavalier (likely around 2.4% of Cavalier's issued capital).

1.2 The parties have negotiated a conditional agreement for sale and purchase relating to the transaction.

1.3 [

]

1.4 The proposal ("**Proposal**") has been structured to include the following aspects:

- (a) Cavalier will incorporate a New Zealand subsidiary ("**NewCo**") and such other subsidiaries as are required to effect the Proposal.
- (b) The NE Shareholders will procure NEHL to sell the Norman Ellison business owned by NEHL and its subsidiaries to NewCo and to such other subsidiaries incorporated for the purpose of acquiring Norman Ellison.
- (c) The NE Shareholders will acquire a 30% stake in NewCo, leaving Cavalier with the balance of 70%.
- (d) Cavalier will issue new shares constituting around 2.4% of its issued share capital to the NE Shareholders as part funding of its 70% capital in Newco.

1.5 At this stage, it is envisaged that there would be three companies to acquire the Norman Ellison business – NewCo, NewCo1 and NewCo2 – which will then be renamed Norman Ellison Carpets Limited, Carpet Distributors Limited and Norman Ellison Carpets Pty Limited respectively.

1.6 Further details are as set out in **Annexure 1**.

2. Who is the person giving this notice?

2.1 This notice is given by:

(a) Victor Tan
Finance Director
Cavalier Corporation Limited
7 Grayson Avenue
Papatoetoe
P O Box 97 040
South Auckland Mail Centre
MANUKAU 2240

Telephone: (09) 277 6000
Facsimile: (09) 279 4756

(b) Russell Harding
General Manager, Operations
Norman Ellison Holdings Limited
273 Neilson Street
Onehunga
P O Box 13 675
AUCKLAND 1643

Telephone: (09) 633 1825
Facsimile: (09) 633 0773

2.2 Please direct correspondence and inquiries to:

Minter Ellison Rudd Watts

Lawyers
Lumley Centre
88 Shortland Street
PO Box 3798
AUCKLAND

Attention: Andrew Matthews / Nicko Waymouth
Telephone: (09) 353 9700
Direct dial: (09) 353 9847 / (09) 353 9837
Facsimile: (09) 353 9701
Email: andrew.matthews@minterellison.co.nz
nicko.waymouth@minterellison.co.nz

3. Confidentiality

3.1 Confidentiality is not claimed for the fact of the proposed acquisition.

3.2 Confidentiality is sought for the information contained in bold and in square brackets in the confidential version of this application (i.e. []).

3.3 Confidentiality is sought until the applicants confirm in writing to the Commission that the particular information is no longer confidential.

- 3.4 This request is made because the information is commercially sensitive and valuable information which is confidential to the applicants. Disclosure of the information would be likely unreasonably to prejudice the commercial position of the applicants. Confidentiality is requested under section 100 of the Commerce Act 1986 and under section 9(2)(b) of the Official Information Act 1982 ("OIA").
- 3.5 The applicants request that they are advised in writing of any requests made to the Commission under the OIA in relation to this application, and that the Commission seeks the applicants' views on whether the information remains confidential and commercially sensitive at the time those requests are being considered.

4. Who are the participants (i.e. the parties involved)?

- 4.1 The participants are Cavalier, Norman Ellison and the NE Shareholders. The NE Shareholders are:
- (a) WB and AR Norman;
 - (b) WB Norman, LM Arbuckle, DM Elliffe, DG Daniel, and AR Norman (for the Norman Family Trust);
 - (c) RJ Harding and R Harding;
 - (d) BE Slade-Jones;
 - (e) WB Norman, DM Elliffe, DG Daniel, and LM Arbuckle (for the Elliffe Family Trust);
 - (f) M Jury (for the Rosewarne Family Trust); and
 - (g) WD Drinkwater
- 4.2 The applicants' contact details are set out in paragraph 2.1 above. Please direct all correspondence and inquiries to Minter Ellison Rudd Watts in the first instance.

5. Who is interconnected to or associated with each participant?

Cavalier Corporation Limited

- 5.1 Cavalier was formed and listed on the New Zealand Stock Exchange (as the NZX was known then) in 1984.
- 5.2 A diagram of the Cavalier group of companies is attached at **Annexure 2**.
- 5.3 A list of Cavalier's top 20 shareholders is attached at **Annexure 3**.

Norman Ellison and the NE Shareholders

- 5.4 The NE Shareholders' identities are as noted in paragraph 4.1 above.
- 5.5 A diagram of the current structure of the Norman Ellison group of companies is attached at **Annexure 4**.

6. Does any participant, or any interconnected body corporate thereof, already have a beneficial interest in, or is it beneficially entitled to, any shares or other pecuniary interest in another participant?

6.1 The applicants are not aware of any such links, other than the fact that WB Norman is the holder of 100 shares, and Douglas McFarlane Elliffe, Annemarie Millar and Craig McFarlane Elliffe (as trustees of the Elliffe Family Trust) also hold 23,556 shares, in Cavalier. Cavalier has 65,495,595 shares on issue.

7. Identify any links, formal or informal, between any participant/s including interconnected bodies corporate and other persons identified at paragraph 5 and its/their existing competitors in each market.

7.1 Cavalier uses its own wool scouring facilities (Hawkes Bay Woolscourers) and, because Cavalier's own scouring needs are less than [] of Hawkes Bay Woolscourers' total capacity, Cavalier provides scouring services to other industry participants including Norman Ellison, through Norman Ellison's independent agent, in the normal course of business, on arms-length terms and at arms-length prices.

7.2 Both Cavalier and Norman Ellison are involved in yarn spinning. However, only Norman Ellison supplies yarn, albeit in limited/modest quantities, to an industry participant in Australia, with all of Cavalier's yarn earmarked for internal carpet manufacturing.

7.3 Neither Cavalier nor the Norman Ellison business has any links, formal or informal, with any competitor in the national carpet market other than as disclosed and then only in the ordinary course of business.

8. Do any directors of the 'acquirer' also hold directorships in any other companies which are involved in the markets in which the target company/business operates?

8.1 No.

9. What are the business activities of each participant?

Cavalier

9.1 As noted earlier, Cavalier was formed and listed on the NZX in 1984. The Cavalier group is involved in:

- (a) the manufacturing and sales of predominantly wool-rich broadloom carpets under the Bremworth, Cavalier Bremworth, Knightsbridge, EnCasa and Kimberley brands,
- (b) the manufacturing and sales of a range of synthetic broadloom carpets that is marketed under the Tramore brand,
- (c) the procurement at the farm gate, and scouring, of raw wool, and
- (d) the manufacturing and distribution of carpet tiles.

9.2 The Cavalier group has about 5,700 shareholders, and employs over 850 staff. It has sales offices throughout New Zealand and Australia, with representation elsewhere

through distributors and agents. Around half its New Zealand broadloom carpet production is exported to Australia, Europe, North America and Asia. For the year ended 30 June 2007, it had operating revenue of \$212 million, and a post-tax net operating surplus of \$15 million (net of minority interests).

- 9.3 The Cavalier group is involved with all aspects of the manufacturing of pure wool broadloom carpet - from the acquisition of wool at the farm gate, through to wool scouring, yarn spinning and carpet tufting, and then distribution of the final product.
- 9.4 In New Zealand, its operations include:
- (a) Elco Direct Limited – a private wool buying operation which sources wool at the farm gate for Cavalier’s own carpet-wool requirements and for the wool exporting industry at large;
 - (b) Cavalier Woolscourers Limited (92.5% owned) – a commission woolscourer which operates as Hawkes Bay Woolscourers in the North Island (Awatoto) and Canterbury Woolscourers in the South Island (Timaru);
 - (c) Cavalier Spinners Limited – carpet yarn manufacturing, with all output from its two spinning plants in Wanganui and Awatoto designated for internal conversion into carpet;
 - (d) Cavalier Bremworth Limited - broadloom carpet manufacturing operation for the group, with its carpet tufting plant based in Auckland. It also distributes carpet under the Bremworth, Cavalier Bremworth and Tramore brands in New Zealand and abroad; and
 - (e) Knightsbridge Carpets Limited and EnCasa Carpets Limited – carpet distribution under their respective brands.
- 9.5 Cavalier’s other interests include Microbial Technologies Limited – a company that is involved in developing a bio-pesticide remedy against fly strikes and lice infestation in sheep.
- 9.6 Cavalier’s Australian interests include:
- (a) Cavalier Bremworth Pty Limited and Kimberley Carpets Pty Limited (broadloom carpet distribution in the Australian carpet market under their respective brands); and
 - (b) Ontera Modular Carpets Pty Limited (carpet tile manufacturing and distribution and 89.5% owned).
- 9.7 For more information, please see **Annexure 2** and www.cavcorp.co.nz.

Norman Ellison

- 9.8 Norman Ellison is a privately owned and operated yarn and carpet manufacturer. It has tufting machinery and a yarn spinning plant located in Auckland. It manufactures tufted wool-rich and wool blend carpets which are marketed under the Norman Ellison Carpets brand. Its products include Accord, Aztec, Boston, Mauritius, and St Tropez.
- 9.9 The Norman Ellison business does not have any interest in any wool scouring plant.
- 9.10 Please see **Annexure 4** and www.normanellison.co.nz for more information.

10. What are the reasons for the Proposal and the intentions in respect of the acquired or merged business?

Background

- 10.1 The carpet industry is extremely competitive with low barriers to entry for new participants. There are a number of specialist “service-for-fee” suppliers on both sides of the Tasman with the capital investment, the capability and the capacity to fill every stage of the carpet manufacturing process - from the acquisition of the fibre, to yarn spinning and through to carpet manufacturing – all on a commission basis.
- 10.2 The suppliers into the industry (the manufacturers and distributors) are fragmented. They share no common vision/expectation as to returns or investments on funds employed. And they have totally different agendas. This is probably driven by the fact that one (Cavalier) is a listed company and is therefore accountable to its shareholders and the others are privately owned companies with a different perspective on earnings.
- 10.3 The increasing trend towards buying groups or co-operatives at the retail level also means that there has been a significant shift in the “balance of power” towards this group of very well-resourced and organised retailers and dealers who are focused on getting the very best for them and their customers. The better endowed ones are also importers in their own right and are capable of getting carpet manufactured for them on a commission basis.
- 10.4 The competition from imports, especially from Australia, is intense because of the ease of entry and the absence of any significant cost impediments (eg. duty and freight). The significant investment in additional capacity in Australia in recent years (driven to a large extent by the Australian Government’s Strategic Investment Programme for the textile industry) and the slowdown in the housing market in Australia have resulted, and will continue to result, in the transfer of that capacity into New Zealand – not just in the form of the finished product, but also in the form of the “service-for-fee” referred to later in this application.
- 10.5 There is, increasingly, the need for the “verticals” (manufacturers with investments in capital assets and who are involved in all/virtually all of the stages of carpet manufacturing like Godfrey Hirst/Feltex , Norman Ellison and Cavalier) to be more cost efficient and to achieve the required economies of scale to withstand the increasingly price competitive nature of the industry.
- 10.6 The challenges faced by these “verticals” are perhaps best illustrated by the financial performance of the hitherto listed Feltex (even after recognising that there may have been other factors as well) and Cavalier’s broadloom carpet business, which recorded an EBIT of \$22.3 million in both 2006/07 and 2005/06, compared with \$28.2 million in 2004/05 and \$28.7 million in 2003/04.

Reasons for the proposal

- 10.7 As the above discussion indicates, the national carpet market is highly competitive, most dramatically evidenced by the collapse of Feltex in September 2006. Godfrey Hirst’s acquisition of Feltex has resulted in an even larger and more efficient entity, brought about by the economies of scale from the enlarged volume base and the rationalisation benefits they have been able to extract from the combined unit. That, coupled with the ever-increasing price-based competition brought about by imports and by the surplus capacity within the industry, can only add to the already competitive nature of the market.

- 10.8 In order to meet this competition, the applicants must seek greater operating efficiencies. The Proposal will enable them to gain significant synergistic benefits and for Cavalier to expand its product range into the middle to lower segments of the market. Cavalier operates predominantly in the higher to mid segments of the market, while Norman Ellison has focused on the middle to lower end of the market, so the Proposal will be complementary. The Proposal will also put the applicants in a stronger position in the broader Australasian “market”, currently dominated by Godfrey Hirst/Feltex, through an expanded distribution network, better product representation and better geographic coverage.
- 10.9 The applicants have identified significant cost reduction opportunities that would arise from the Proposal - from purchasing efficiencies to resource sharing, including:
- (a) reductions in raw material costs through increased purchasing power, where savings/synergistic benefits of around [] have been identified;
 - (b) reductions in manufacturing overheads from the more efficient utilisation of manufacturing facilities and processes, where savings/synergistic benefits of around [] have been identified;
 - (c) sharing of administration support and information systems, where savings/synergistic benefits of around [] have been identified.
- 10.10 The Proposal will also allow greater access to, and penetration into, the Australian carpet market through better support services and a more comprehensive product range. For example, Cavalier will be able to increase its presence in Queensland by utilising Norman Ellison’s facilities in Brisbane, while Norman Ellison will be able to do likewise in New South Wales through Cavalier’s facilities in Sydney.
- 10.11 The Proposal will also result in Cavalier acquiring complementary product ranges. Norman Ellison has a number of products in the 50/50 wool/synthetic blends which best suit the residential contract segment - a segment that Cavalier has not focused on, so the Proposal will enable it to expand in a relatively low-cost, low-risk way.

Plans for the merged entity

- 10.12 Because of the competitive nature of the market and the risk of losing market share, it is very important for Cavalier and Norman Ellison to continue to maintain their separate identity in the market place post acquisition.
- 10.13 Therefore, the applicants expect that there would be no/little change in the respective sales and marketing strategies/approaches of the two entities, with the benefits of the merger expected to come from synergistic benefits in manufacturing and support services.
- 10.14 Nor will there be a merger of the sales force which will be expected to continue to service their respective customer base in the normal manner. This same approach was adopted in the recent *Godfrey Hirst/Feltex* merger and in the recent *ANZ/National Bank* merger where the parties have sought to retain market share by maintaining the separate marketing and brand philosophies of the underlying units.

PART II: IDENTIFICATION OF MARKETS AFFECTED

Horizontal aggregation

11. Are there any markets in which there would be an aggregation of business activities as a result of the proposed acquisition?

Please identify for each market:

- the product(s), functional level, geographic area and (where relevant) timeframe;
- the specific parties involved;
- the relationship of those parties to the acquirer or target company as the case may be.

11.1 The Proposal will result in aggregation in the manufacturing (including yarn manufacturing) and wholesale supply of carpet.

Aggregation of business activities

11.2 **Diagram 1: Aggregation from Proposal – activities of Cavalier and Norman Ellison**

	Wool Procurement	Wool Scouring	Yarn Spinning	Carpet Production	Carpet Sales	Carpet Imports
Cavalier	YES North Island	YES North and South Islands	YES Wanganui Awatoto	YES Auckland	<p>New Zealand Bremworth, Cavalier Bremworth, Knightsbridge, EnCasa and Tramore brands</p> <p>Australia Bremworth, Cavalier Bremworth, Kimberley and Tramore brands</p>	NO
Norman Ellison	NO	NO	YES Auckland	YES Auckland	<p>New Zealand Norman Ellison Carpets (wool-rich and wool blends) and imported and internally manufactured synthetics</p> <p>Australia Norman Ellison Carpets (wool-rich and wool blends) and imported and internally manufactured synthetics</p>	YES

11.3 The Commission recently considered the carpet industry and defined the relevant market in *Decision No. 587, Godfrey Hirst/Feltex Carpets* (31 August 2006). The Commission defined the relevant market as the national market for the manufacture/import and wholesale supply of carpet (“**national carpet market**”). In doing so, the Commission concluded that “... *yarn spinning can be assessed as a vertically integrated component of the carpet manufacturing process, rather than requiring separate analysis*”.¹

11.4 The applicants agree with both the Commission’s reasoning and conclusions in *Decision No. 587*.

11.5 Given the detailed summary of the wool industry in that recent decision (see paragraphs 24-71), this application does not provide a general industry background or discussion of market definition. For completeness, the applicants note that Norman

¹ para 42
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Ellison do not supply wool scouring services so, unlike *Decision No. 587*, the Proposal will not result in aggregation in the market for the supply of scouring services.

11.6 The applicants do, however, wish to comment on the geographic market definition. The applicants appreciate that the Commerce Act restricts the *geographic market* to New Zealand and that there are obvious jurisdictional reasons for this. If that were not the case, then the applicants consider that the supply-side (ie economic) reality could well justify defining the market as “**Australasia**”:

- there is free market access, with no duty trans-Tasman under CER;
- trans-Tasman freight costs are modest - \$0.35 per square metre or around 2% of the estimated CIF price;
- styles of carpets are reasonably common/similar between the two countries and are so easily “transferable” that manufacturers are able to service both markets with predominantly the same range of products; and
- surplus capacity is easily transferable from Australia to NZ and vice versa

11.7 There are naturally more manufacturers in Australia than in New Zealand due to the larger market size (55.3 million square metres versus the 11.7 million in NZ). The larger ones (ranked in order of estimated volume) are:

- Godfrey Hirst/Feltex
- Beaulieu
- Victoria Carpets
- Tuftmaster Carpets
- Quest Carpet Manufacturers
- Northstate Carpet Mills

11.8 Most of the above already have a presence in NZ, either as direct distributors or via NZ-based distributors.

Differentiated product markets

12. Please indicate whether the products in each market identified in question 11 are standardised (buyers make their purchases largely on the basis of price) or differentiated (buyers make their purchases largely on the basis of product characteristics as well as price).

12.1 As discussed in *Decision No. 587*, carpet can be manufactured from 100% wool, 100% synthetic fibres or a blend of both. Cavalier and Norman Ellison both produce carpets utilising these fibres and, in the case of Norman Ellison, a blend of them. The price and quality of carpet varies over a large spectrum. While synthetic carpet has a tendency to occupy the lower price-end of the spectrum and wool carpet the higher price-end, high quality synthetic carpet does compete with wool carpet, particularly in the mid-market segment. In some instances, very good quality synthetic products do compete with wool at the higher price-end of the market.

12.2 While wool carpet has traditionally been preferred in New Zealand due to historical reasons, synthetic carpets’ market share has been increasing over the last five years. This is primarily due to quality improvements, durability features, the preferences of new immigrants and the dominance of synthetics overseas.

12.3 Essentially, it is the pricing, colour, style and texture of the carpet that dictates the customer’s final choice. Carpets constructed of the various fibre types remain viable substitutes for, and readily compete with, each other.

12.4 The Commission has noted:

“... There is no single overriding consideration that is common to a consumer’s choice and that typically the consumer will weigh all factors in forming a view on what is most suited to his or her needs and budget.”²

12.5 While branding is a significant feature of the sales process, consumer purchasing decisions are driven heavily by price. As such the product market is “standardised” to a degree, but the applicants agree with the Commission that *“... it is not necessary to further disaggregate the market to specify different material inputs, methods of manufacture or end-product quality. Instead the Commission considers that all carpets fall within a single differentiated product market.”³*

13. For differentiated product markets:

- Please indicate the principal characteristics of products that cause them to be differentiated one from another.
- To what extent does product differentiation lead firms to tailor and market their products to particular buyer groups or market niches?
- Of the various products in the market, which are close substitutes for the products of the proposed combined entity? – which are more distant substitutes?
- Given the level of product differentiation, to what extent do you consider that the merged entity would be constrained in its actions by the presence of other suppliers in the market(s) affected?

13.1 This is discussed in section 12 above.

13.2 In short, there is product differentiation but price and individual preference are the primary determinants.

Vertical integration

14. Will the Proposal result in vertical integration between firms involved at different functional levels?

14.1 The Proposal is fundamentally a horizontal merger, but has a vertical dimension as Norman Ellison is a customer in the upstream activities of wool acquisition and scouring, activities in which Cavalier is involved.

14.2 The Proposal does not, however, raise any foreclosure or other vertical concerns:

- (a) Norman Ellison is not involved in wool scouring as it currently acquires its scoured/clean wool requirements through an independent agent on a scoured/clean basis;
- (b) Norman Ellison acquires around [] of its wool from New Zealand Wool Service Limited (“NZWS”) – this would be around [] tonnes (greasy) per annum, accounting for just [] of NZWS’s estimated [] tonnes (greasy) annual throughput at its North Island scour;
- (c) the other two suppliers of scouring services are Godfrey Hirst and Cavalier, so it is possible that Godfrey Hirst could lose some scouring if Newco were to

² Decision No. 587, para 50

³ Ibid, para 55
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resort to Cavalier's scouring facilities. However, the impact of this volume loss would also be insignificant on Godfrey Hirst, just as it would be on NZWS.

14.3 The applicants note that the vertically related markets and relevant participants are discussed in *Decision No. 587*.

15. In respect of each market identified in questions 11 and/or 14 identify briefly:

- all proposed acquisitions of assets of a business or shares involving either participant (or any interconnected body corporate thereof) notified to the Commission in the last three years and, in each case:
 - the outcome of the notification (e.g. cleared, authorised, declined, withdrawn)
 - whether the proposed acquisition has occurred.
- any other acquisition of assets of a business or shares which either participant (or any interconnected body corporate) has undertaken in the last three years.

15.1 Neither party has notified any acquisition or proposed acquisition, or been the target of such a notification, to the Commission in the past three years.

15.2 In August 2005, Cavalier's 92.5% owned Hawkes Bay Woolscourers acquired a 50% interest in Canterbury Woolscourers – an independent commission wool scour that was set up in the South Island at the time to acquire and consolidate two pre-existing wool scours. In July 2007, Hawkes Bay Woolscourers acquired the remaining 50% it did not already own in Canterbury Woolscourers, thus making Canterbury Woolscourers its fully owned subsidiary.

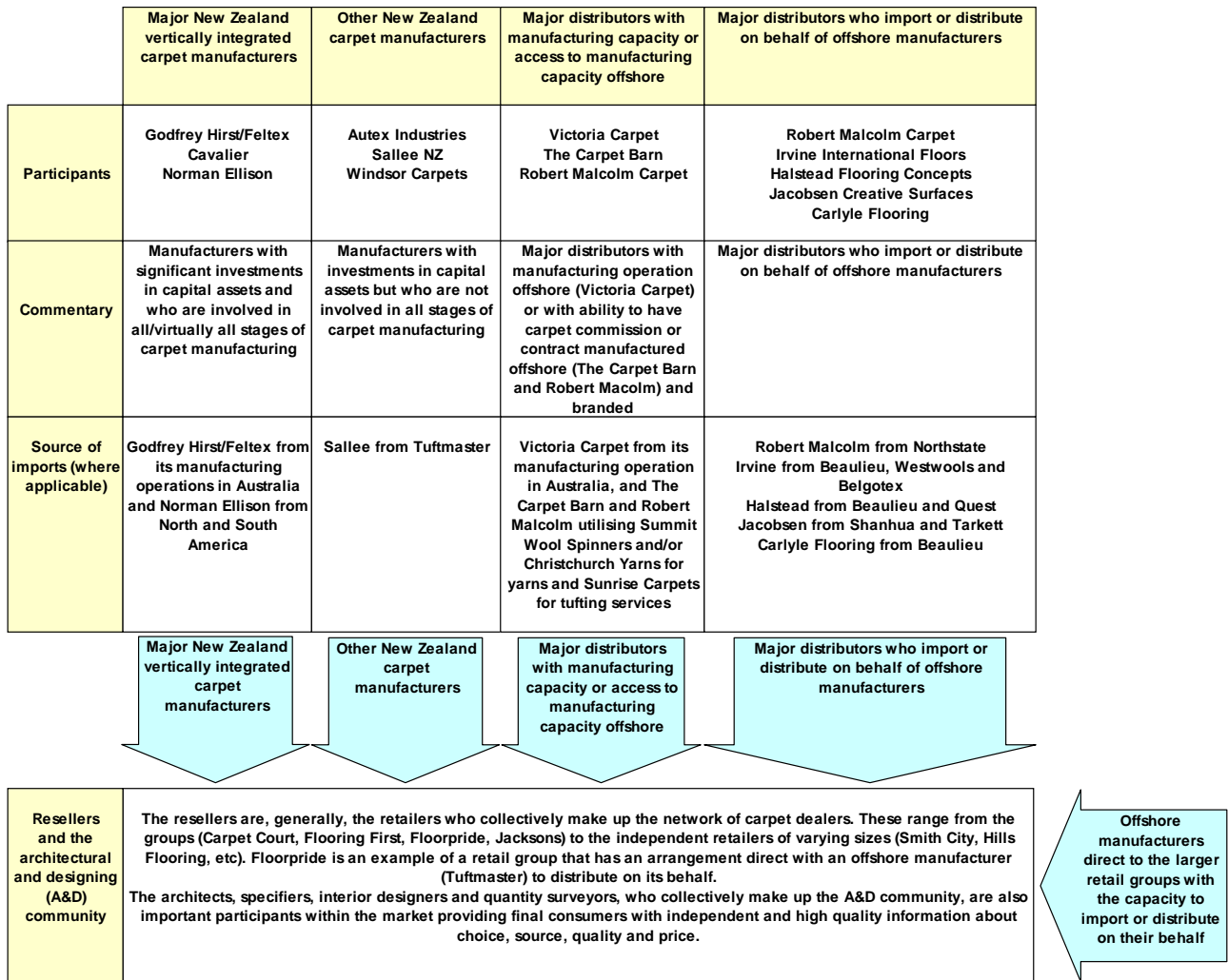
PARTS III CONSTRAINTS ON MARKET POWER BY EXISTING COMPETITION

16. Existing competitors

16.1 The below diagram shows the participants in the national carpet market, the various levels at which they participate and the roles they play in supplying the re-sellers in the market.

National carpet market

16.2 Diagram 2: The participants who supply the re-sellers in the market



16.3 There are a number of domestic manufacturers and importers. The main suppliers are as noted below:

New Zealand based manufacturers

- (a) **Godfrey Hirst/Feltex:** Godfrey Hirst/Feltex has manufacturing units on both sides of the Tasman with common product ranges sold in both countries. While Godfrey Hirst now owns Feltex, it has continued to operate Feltex under the Feltex brand and as a separate unit:

- (i) **Godfrey Hirst:** The Godfrey Hirst group is a vertically integrated carpet manufacturer, supplying tufted synthetic carpets through operations in Australia and New Zealand. Godfrey Hirst “has over 140 years of manufacturing experience”, describing itself as “Australia’s largest tufted carpet manufacturer, distributor and exporter”, noting that its turnover exceeds AU\$200 million. It has fully owned subsidiaries in the US, Canada, Hong Kong, Singapore and New Zealand. Godfrey Hirst is ultimately owned by the McKendrick family and their related interests. (Please refer to *Decision No. 587*, and the related clearance application (“*GH Application*”).)⁴
- (ii) **Feltex:** Feltex is Australasia’s largest manufacturer of residential and commercial carpets and was established over 70 years ago. Feltex describes itself on its website as having “quality technical expertise and unparalleled craftsmanship as a cornerstone of all we do”. It also describes its operation as including six spinning mills, 3 tufted carpet mills, and offices in New Zealand, Australia and the United States. It also claims to lead the way in exports, exporting around 60% of production. Customers are spread throughout the world including South East Asia, Japan, United States, the Middle East and other key world markets. Feltex has been the chosen supplier to such projects as the Ritz Carlton in California and the University of Otago in New Zealand. Feltex produces more than 25% of all carpet in Australia and New Zealand and is one of the world’s most dominant producers of natural wool carpets.⁵

In terms of size, Godfrey Hirst/Feltex accounts for the following:

- In NZ (market size of 11.7 million m²), a market share of around [] (compared with Cavalier’s [] and Norman Ellison’s [])
- In Australia (market size of 55.3 million m²), a market share of around [] (compared with Cavalier’s [] and Norman Ellison’s []).

- (b) **Autex Industries:** Autex is a locally owned firm established in 1967. The companies making up the Autex Group include Autex International Limited, the parent company; Autex Industries Limited, the New Zealand-based manufacturing interests; Autex Pty Limited (with its Australian manufacturing units based in Melbourne, Sydney and Perth); Autex Properties Limited; and Autex Investments Limited. Originally a manufacturer of jute-based carpet underfelts, it later established a new plant to produce polypropylene needle punch carpets. On its website it claims that it utilises its strong textile engineering skills base in the manufacture of its carpets. The company was able to adapt and develop new manufacturing techniques in products suited specifically for the New Zealand market and a growing export market. Autex states that it has strong relationships with long-term distributors in every Australian state and has begun exporting to Asia from its manufacturing plants in Australia. Autex has been the chosen supplier for such projects as Crowne Plaza Auckland, ABN AMBRO Craigs, Les Mills and North Shore Events Centre.⁶
- (c) **Sallee NZ:** Sallee was established over 30 years ago and claims to be New Zealand’s leading manufacturer and supplier of custom made carpets and area rugs. Sallee considers itself to be a “niche operator” as it focuses on custom manufacturing specialising in “very high end products”⁷. They also claim to

⁴ <http://www.godfreyhirst.com> and see also <http://www.godfreyhirst.co.nz>

⁵ http://www.feltex.co.nz/feltex_corporate/index.asp; see also the *GH Application*.

⁶ <http://www.autex.co.nz/>

⁷ *Decision No. 587*, para 94

offer unrivalled flexibility in carpet colour, texture and product and have 3 showrooms located in Auckland, Wellington and Christchurch.⁸

- (d) **Windsor Carpets:** While Windsor Carpets of New Zealand (“**Windsor**”) has predominately manufactured bathroom carpets for the New Zealand market they have, over the last 18 months, started to tuft wool sisal carpets for supply through the Flooring First Group. We believe that it is also now manufacturing and marketing a synthetic product. Windsor has recently employed Grant Harsenhorst as their New Zealand sales manager in order to increase their share of, and profile in, the carpet market. Harsenhorst has a wealth of carpet industry experience having previously been employed at Feltex for a large number of years and for the last five years was the General Manager of Flooring First. The recruitment of Harsenhorst exemplifies Windsor’s expansionist ambitions.

Australian based manufacturers

- (e) **Godfrey Hirst/Feltex:** Refer to 16.3 (a) above
- (f) **Beaulieu:** Internationally owned and regarded as one of Australia’s largest carpet manufacturers. Based in Queensland, it supplies its carpet into New Zealand for distribution by Halstead Flooring and Carlyle Flooring.
- (g) **Victoria Carpets:** Victoria Carpets was established in 1954 by Victoria Carpets of the United Kingdom, established 1895. It has now grown to become a leading Australian carpet manufacturer. The company’s manufacturing base is located in Dandenong, Victoria and it has spinning mills in both Castlemain and Bendigo in New South Wales and Queensland respectively. The Company employs over 300 people across these three facilities and has sales forces throughout New Zealand and Australia. The company incorporated two spinning mills into its structure in 1992 and 2003. This allowed it the flexibility to produce wool, wool blends and synthetic carpets. Victoria Carpets have obtained ISO 9001-2000 quality accreditation. The company claims to continually invest in modern equipment to ensure that product quality remains first class and Victoria Carpets retains its reputation for excellence. Victoria Carpets has been chosen for a number of prestigious hotel and development projects throughout Australia including Eureka Tower, Crown Towers, Federation Square, World Tower, Hyde Park Plaza and Morteon.⁹ Victoria Carpets has its own sales office in New Zealand and a warehouse based in Auckland. It distributes its own products and current estimates point to sales of [] square metres per annum in New Zealand.
- (h) **Tuftmaster Carpets:** Sydney-based carpet manufacturer that produces 1.8 million square metres per annum. Tuftmaster Carpets recently signed an exclusive deal in the South Island with Floorpride to distribute its entire collection of carpet, which includes a range of wool carpet offerings.
- (i) **Quest Carpets:** Quest Carpets of Australia, through its New Zealand distributor Halstead Flooring, is now distributing one range of cut pile wool carpets through Flooring First. These cut piles are being sold under the “Blue Label Collection”, a Flooring First in-house brand.
- (j) **Northstate Carpet Mills:** Based in Queensland, Northstate is a specialist synthetic carpet manufacturer. It distributes in New Zealand through Robert Malcolm in Christchurch.

⁸ <http://www.sallee.co.nz/>

⁹ <http://www.victoriacarpets.com.au/>

Importers

- (k) **The Carpet Barn:** The Carpet Barn is a major stockist and the New Zealand importer and distributor of “Burlington” wool carpets, contract manufactured for it in Australia (by Sunrise Carpets Industry Pty Limited, which is covered in more detail at 17.1(d)). The Carpet Barn claims, on its website, that it shares its premises with a major New Zealand carpet distribution centre. This enables it to offer wholesale prices direct to the end user cutting out the retailer and saving the consumer money. It also claims that by providing independently owned stores it also eliminates uncompetitive nationwide price plans by bringing the best deals in carpets to the consumer. Burlington has continued to strengthen its distribution network over the last 18 months and now has at least 10 strategically located retail shops along with a number of carpet layers/agents that offer this range to the market. The applicants estimate that Burlington has increased its business to around [] square metres per annum or [] market with a view to continue this growth exponentially.
- (l) **Robert Malcolm Carpet:** Robert Malcolm is a Christchurch based distributor who also has carpet manufactured on a commission basis by Sunrise. Robert Malcolm sources yarn from Summit Wool Spinners and maybe Christchurch Yarns for this commission carpet. This carpet is then returned to New Zealand for distribution, together with the synthetic carpet it sources from Australian manufacturer Northstate Carpet Mills, thus allowing it to continue to increase its offerings and market share in the New Zealand carpet market.
- (m) **Irvine International Flooring Limited (IIFL):** IIFL was established over 20 years ago and it claims to have had tremendous growth over this period. IIFL also claims to have an extensive range of products and skilfully applies its knowledge to interpret emerging trends and reflect those in its design and colour selections. It is our understanding that it sources carpet from countries as far away as South Africa and Belgium.¹⁰
- (n) **Jacobsen Creative Concepts:** Jacobsen’s exclusively distribute a high quality polypropylene carpet from Shanhua Carpets, which is one of China’s largest carpet manufacturers. They also sell commercial carpet including Tarkett that is described on their website as a leading manufacturer of commercial carpet.¹¹
- (o) **Halstead Flooring Concepts:** Halstead offers five ranges of domestic and commercial carpet that are supplied by Australian-based Beaulieu and Westwools. Halstead claims, on its website, to be well recognised as an innovate leader in the New Zealand flooring industry.¹²
- (p) **Floorpride:** A South Island based retail group that has just signed an exclusive deal with Tuffmaster Carpets in Sydney to distribute its entire offering of carpet, which includes a range of wool carpet.

¹⁰ <http://www.irvineinternational.com/>

¹¹ source: <http://www.jacobsens.co.nz/>

¹² source: <http://www.halstead.co.nz/>

Estimated market shares

16.4 **Table 1: NZ Carpet Market: Market Shares**

Supplier	Estimated Total Volume 000s sq metres	% of Estimated Total Volume
Carpet Manufactured and Sold in New Zealand		
Godfrey Hirst/ Feltex	[]	[]
Cavalier Corporation (actual)	[]	[]
Norman Ellison (actual)	[]	[]
Autex	[]	[]
Sallee	[]	[]
Windsor	[]	[]
New Zealand Total	9,308	79.4%
Imports into New Zealand		
Godfrey Hirst/ Feltex	[]	[]
Norman Ellison (actual)	[]	[]
Victoria Carpets	[]	[]
Carpet Barn	[]	[]
Robert Malcolm	[]	[]
Others (Irvine/Halstead Brintons/Jacobsen etc)	[]	[]
Import Total	2,419	20.6%
Total Market Supply	11,727	100.0%

Source: Total volume figures from NZ Department of Statistics year to September 2006; splits by suppliers are the applicants' estimates

16.5 The increased competitiveness of imports is exacerbated by a progressive reduction in tariffs. Currently, imported carpet (other than that from Australia that attracts no tariff) attracts a tariff of 15% except for developing countries which attract a tariff rate of 13.5%. The tariff rate for developed countries will drop to 10% in July 2009, per table below.¹³

16.6 **Table 2: New Zealand Tariff Duty Payable on Carpet Imports**

July 2006	July 2007	July 2008	July 2009
17%	15%	12.5%	10%

Source: Information provided by MED.

16.7 The applicants agree with the Commission's conclusion in Decision No. 587 that imported carpet "...is likely to become even more competitive in the following few years as tariffs get reduced to 10%".¹⁴

16.8 While the Commission guidelines do not give a specific market share that imports must obtain, and maintain, to be considered a credible constraint, the ACCC guidelines do. The ACCC guidelines states that:

The Commission has not objected to any merger where comparable and competitive imports have held a sustained market share of 10 per cent or more for at least three years, and — as an indicative guideline — is unlikely to do so. However, it should be

¹³ Decision No. 587, para 105

¹⁴ Para 109

emphasised that it is not the historical share of imports that is significant, but their potential to constrain the price and output decisions of the merged firm.¹⁵

16.9 The market share held by imported carpet in New Zealand has been in excess of 20% for the last nine years, and over 10% for the last 17 years, despite some wild fluctuations in the New Zealand dollar over that time and the potential of imports to further constrain the merged entity is only predicted to increase in the coming years as tariffs reduce.

16.10 The applicants agree with the views expressed by flooring retailers in *Decision No. 587*.

[], advised the Commission that carpet could be easily sourced and imported from overseas. [] informed the Commission that he was currently happy with the terms of trade negotiated with the manufacturers in New Zealand, but at any point he could easily switch to importing carpet from Australia or even China.

[], which is a retailer of flooring products, informed the Commission that all of the carpet sold by [] is imported. [] stated that there is no noticeable difference in quality or price between imported carpet and domestically produced carpet. .¹⁶

16.11 Australian carpet manufacturers account for 74% of all carpet imported into New Zealand. Carpet imports from Australia are significant as they do not attract any tariffs and trans-Tasman freight costs, at around 2% of the estimated CIF price.

Exports

16.12 A further competitive constraint is the ability of NZ-based exports to be diverted to the New Zealand market if domestic prices rise. The Commission has previously recognised the constraint posed by suppliers' ability to direct export sales in this way.¹⁷

16.13 For the year ended 30 September 2006, New Zealand manufactured exports of carpet accounted for 30% of total carpet production. Given all the factors already discussed earlier (eg. "transferability" of products across the Tasman because of commonality/similarity of product styles), it would be very easy and indeed compelling for a local manufacturer to retain local production for local consumption rather than for exports should prices increase substantially and local conditions improve. The other appeal for local manufacturers would of course be the removal of the currency risks associated with exporting.

16.14 In reality though, we would also see an influx of imports into the New Zealand national carpet market!

16.15 The applicants do not consider that either of them can be described as a "maverick".

17. Conditions of expansion

17.1 Barriers to expansion are low:

- (a) The applicants know of no reason why Godfrey Hirst/Feltex could not make use of their current surplus capacity and increase production. This could be implemented without further capital investment and in a timely fashion. Additional labour would be the only requirement and there is a reasonable pool of skilled workers available. Sourcing and installing additional broadloom

¹⁵ para 5.111, p. 47

¹⁶ Paras 107-108

¹⁷ *Decision No. 468*, para 145

tufting machinery and/or re-commissioning previously moth-balled plant and equipment could be achieved within *six months*. Capital outlays are not going to present a large obstacle to expansion. Godfrey Hirst/Feltex are both involved in all aspects of the manufacturing process, are endowed with well established brands and have mature sales and distribution infrastructure. There is no reason why an expansion of Godfrey Hirst/Feltex's operations could not be implemented within the one-year time frame in the Commission's *Guidelines*.

- (b) Additionally, the three smaller carpet manufacturers in New Zealand – Autex, Sallee and Windsor – could easily expand their production capacities by investing in additional working capital without the need for significant investment in plant and equipment if Godfrey Hirst/Feltex and Cavalier/Norman Ellison attempted to reap supra-competitive profits. There is no impediment to Autex, Sallee and Windsor and aspiring manufacturers sourcing additional yarn given the existence of the two major independent yarn spinners in the South Island (Summit Wool Spinners Ltd and Christchurch Yarns Ltd). Again expansion could occur within the one-year time frame in the Commission's *Guidelines*.
- (c) Market expansion for importers is relatively easy. All of the current importers could easily expand their operations with minimal additional expenditure. The reduction in tariffs over the coming years will provide added incentive for importers to form strategic alliances with retailers and will undoubtedly make the imported product more attractive to the ultimate consumer.
- (d) Having carpet made on a commission basis is a growing trend and enables smaller players in the industry to move into quasi-manufacturing. Sunrise Carpets Industry Pty Ltd ("**Sunrise**") of Victoria, Australia operates as a contract manufacturer to the carpet industry for a fee. Sunrise already produces carpet on commission for The Carpet Barn (Hamilton) and Robert Malcolm (Christchurch). As well as Sunrise, there is also the "service-for-fee" provider Independent Carpet Company ("**Independent**") also located in Victoria. In addition to providing a complete manufacturing service, Sunrise and Independent provide carpet *finishing* on a "service-for-fee" basis for a group of manufacturers who provide "service-for-fee" tufting. Some of these manufacturers are Chaparral, Supertuft, Frontier and Combined. Australia has seen significant capital investment in carpet manufacturing (driven to a large extent by the Australian Government's Strategic Investment Programme for the textile industry) and the capacity being generated at the various stages of the manufacturing process will have to be absorbed. If Australia fails to use this excess capacity then a significant opportunity will exist for commission produced carpet to expand. This area will likely grow as demand for this particular type of "service-for-fee" arrangement gains traction among other existing distributors and retailers. The likely expansion of commissioned carpet will provide added constraint on the merged entity.
- (e) The ability to also now access the specialised warehousing and distribution services offered by freight forwarding specialists, Paloga (NZ) Limited, means that there is no longer the need to even invest in warehousing and storage for the aspiring carpet importer.

17.2 The lack of expansion barriers and dynamic nature of the New Zealand carpet market generally can be seen by a number of significant developments between manufacturers, distributors and retailers over the past 18 months:

- (a) Quest Carpets of Australia, through its New Zealand distributor Halstead Flooring, is now distributing a range of cut pile wool carpets.

- (b) Another Australian manufacturer Tuftmaster Carpets recently signed an exclusive deal in the South Island with Floorpride to distribute its entire collection.
 - (c) Robert Malcolm continues to purchase yarn from Summit Wool Spinners and maybe Christchurch Yarns and have carpet commission tufted in Australia for subsequent distribution in New Zealand.
 - (d) Similarly, The Carpet Barn now offers a range of wool carpets under the brand name Burlington Carpets, with an enhanced distribution network (at least 10 strategically located retail shops along with a number of carpet layers/agents).
 - (e) Windsor have started to tuft wool sisal carpets for supply through the Flooring First Group and employed an experienced New Zealand sales manager to increase their share of the carpet market.
- 17.3 The proposal would result in the merged entity having around a [] market share (combining Cavalier's [] and Norman Ellison's []). It would still be the number two player in the market as Godfrey Hirst/Feltex has around [] market share. The proposal would only make Cavalier/Norman Ellison a stronger number two; such is Godfrey Hirst/Feltex's dominance of the Australian market (a combined Cavalier/Norman Ellison would only have a [] share of the Australian market compared to Godfrey Hirst/Feltex's [] share of the Australian market). Godfrey Hirst/Feltex faces no barriers to expansion.
- 17.4 The merged entity would not only be constrained by the powerful "Number 1" player, it would also face competition from the other domestic manufacturers (Autex, Sallee and Windsor) and offshore manufacturers (such as Victoria Carpets). Imports already account for around 21% of the market. As the Commission has already acknowledged, imports are not only an existing strong constraint, but an increasing constraint as tariffs reduce further.
- 17.5 The additional constraints from potential new entry and acquirers are discussed below.
- 17.6 A list containing the email addresses of New Zealand manufacturers and distributors, Australian manufacturers, other foreign manufacturers, and New Zealand and Australian commission providers is set out in **Annexure 5**.

18. Coordinated market power

- 18.1 There is minimal scope for collusion in the market for supply of carpet. Following the Commission's *Guidelines*:
- (a) there is a high degree of competition between existing participants;
 - (b) product is slightly differentiated for differing end users;
 - (c) new entry can occur quickly;
 - (d) there are a number of fringe players in the industry;
 - (e) neither of the parties are "mavericks"
 - (f) alternative sales channels ensures that demand is elastic;
 - (g) there is no history of collusion in the industry;

- (h) customers exercise considerable countervailing power; and
 - (i) retailers are well informed about prices and can readily switch suppliers in response to price and service level differentials.
- 18.2 The applicants consider that the constraint imposed by the conduct of existing competitors (especially Godfrey Hirst/Feltex) is sufficient to ensure that competition would not be substantially lessened in any market. However, for completeness, and given the particularly strong countervailing power of customers, they have chosen to complete the application form.

PART IV: CONSTRAINTS ON MARKET POWER BY POTENTIAL COMPETITION

19. Conditions of entry

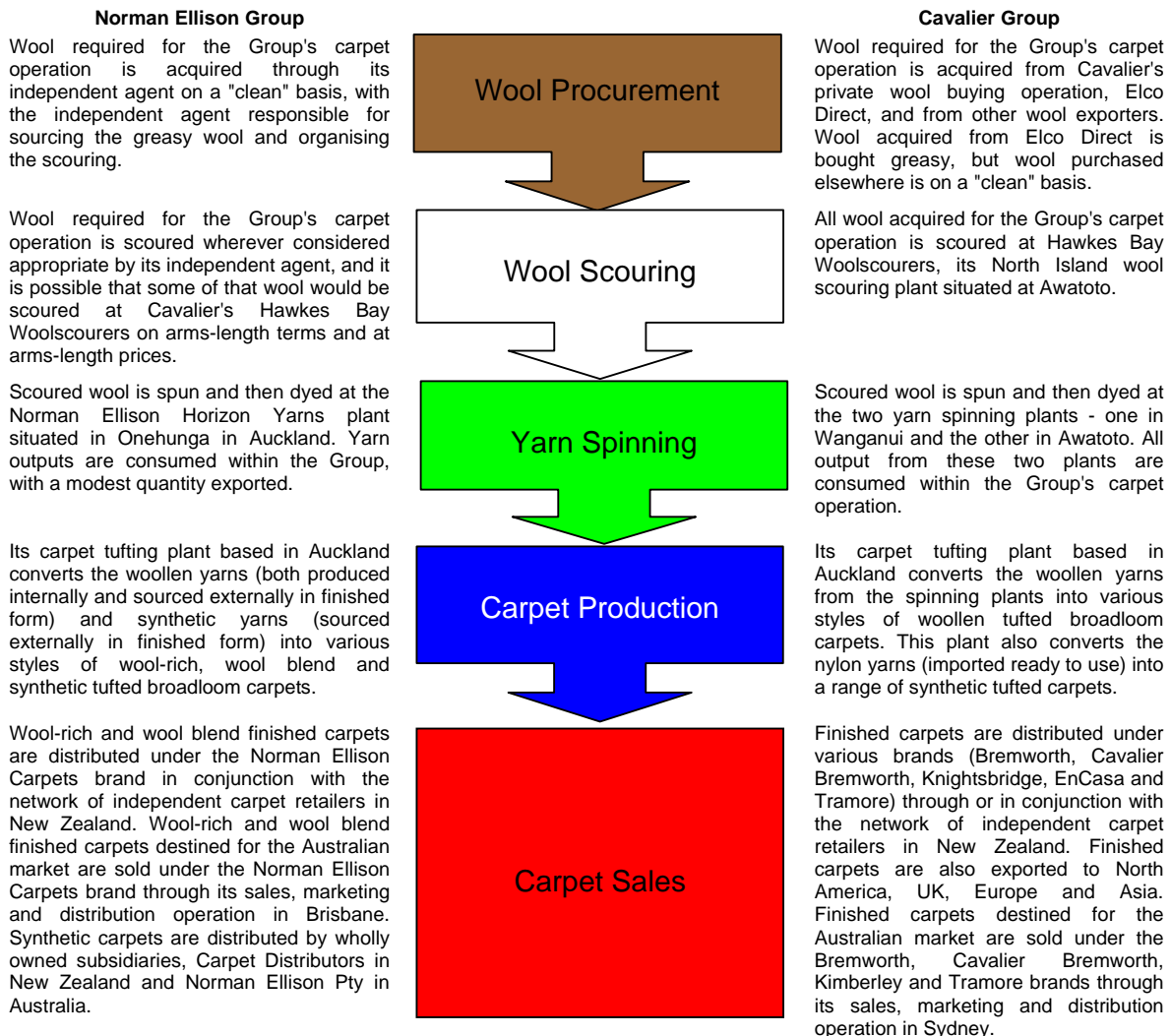
19.1 The applicants consider that a new carpet manufacturing facility, with the capacity to take a 5 to 10% market share relatively quickly, can be set up within 12 months.

19.2 To understand the ease of entry for a new competitor, or expansion by an existing competitor (including importers), it is helpful to illustrate the tufted carpet manufacturing process. Essentially, it involves the following in the case of tufted woollen carpet:

- (a) Removing of grease and dirt from the greasy/raw wool off the sheep's back to get scoured/clean wool (**scouring process**),
- (b) Carding, twisting, spinning and dyeing scoured/clean wool to produce woollen carpet yarn (**spinning process**), and
- (c) Converting the yarn into carpet (**tufting process**)

Carpet manufacturing process

19.3 Diagram 3: Applicants' vertically integrated carpet manufacturing process



- 19.4 In the case of tufted synthetic carpet, the process starting point depends on whether fibre is sourced (in which case, there will have to be conversion into yarn first) or whether yarn is sourced ready for tufting into carpet.

Access to Wool Scouring

- 19.5 Both Godfrey Hirst/Feltex and Cavalier have their own wool scouring facilities. However, because their own scouring needs for carpet manufacturing are only a fraction of the total capacity of these facilities, they are service providers to the market at large. Scouring services are provided at market prices. For instance, Cavalier only requires scouring for around [] bales of greasy wool per annum, but its scouring plant at Napier scours around [] bales per annum. The rest of the scouring ([] bales) are for, amongst others, carpet and yarn manufacturing plants in New Zealand (including Norman Ellison), Australia and all around the world – generally through the many independent wool exporters in the country.
- 19.6 In addition, there is the NZX listed NZWS. NZWS is an independent operator with two scours - one in the North Island (Napier) and the other in the South Island (Invercargill). NZWS operates as another important “service-for-fee” provider in this area. The combination of these three scours (Godfrey Hirst/Feltex, Cavalier and NZWS) has resulted in excess scouring capacity in the country and pricing is fiercely competitive. Thus, there is unimpeded access to wool scouring services for any new entrant.

Access to Woollen Carpet Yarn/Woollen Carpet Yarn Spinning Facilities

- 19.7 Both Godfrey Hirst/Feltex and Cavalier have their own yarn spinning facilities. However, since there is not the surplus capacity that is present in scouring, no yarn is sold externally by Cavalier and – the applicants understand - very little by Godfrey Hirst/Feltex. Norman Ellison has its own yarn spinning facility, but unlike Godfrey Hirst/Feltex and Cavalier, it does offer a minimal quantity of that capacity towards supplying an Australian carpet manufacturer.
- 19.8 Summit Wool Spinners Limited and Christchurch Yarns Limited are independent spinners who currently supply those Australasian carpet manufacturers/distributors who do not have their own carpet yarn spinning facilities. Both currently have surplus capacity so yarn is freely available to any new entrant.
- 19.9 In addition to the two major independent yarn spinners, carpet yarn is also produced by two other independent yarn spinners - Woolyarns in Wellington and Lana Spinning in Palmerston North. Although smaller than Summit Wool Spinners and Christchurch Yarns, together, we believe that they currently produce [] tonnes per year of carpet yarn (enough for approximately [] square metres of carpet). In the case of Woolyarns, their capacity can be easily increased by introducing extra shifts.

Access to Synthetic Fibre or Synthetic Carpet Yarn

- 19.10 Synthetic fibre and synthetic carpet yarn are freely available as imports. They can be imported in either raw material form (fibre) for conversion into yarn by one of the local yarn spinning mills or as finished yarn ready for conversion into carpet. Prices are very competitive with a number of suppliers to choose from. Some of the major synthetic fibre and synthetic carpet yarn manufacturers are Invista, Universal Fibres, Solutia and Aquafil.
- 19.11 Thus, a new entrant can easily source synthetic fibre or synthetic yarn.

Access to Carpet Manufacturing Facilities

- 19.12 As discussed at 17.1(d) above it is possible for carpet to be manufactured on a commission basis. This would allow, on an interim basis, a new entrant the means to

get product to market (whilst a new carpet manufacturing facility is being set up) thus shortening the timeframe for the new entrant to reach normal operating capability.

- 19.13 With the emergence of the independent “service-for-fee” providers covering the whole spectrum of the tufted carpet manufacturing process, it is now relatively easy for a new participant to enter the industry at a number of levels (for example, enter carpet manufacturing whilst relying on others for carpet yarn, or simply get into carpet distribution with minimal or no investment in plant and equipment), or an existing participant to shift to a higher level (for example, a substantial carpet retailer moving to having its own product manufactured to its own specifications on a commission basis). This is in contrast to just remaining a “passive distributor” simply buying from the existing local carpet manufacturers or importing on a “take it or leave it” basis and performing the traditional roles of a wholesaler.
- 19.14 The applicants believe that it would be very compelling for a “passive distributor” to move away from traditional wholesaling towards contract manufacturing because they can:
- (a) have more control of the end-product,
 - (b) develop their own range of “house brands”, and
 - (c) presumably retain not just the wholesaler’s margins, but some of the manufacturer’s margins as well in the process.
- 19.15 In fact, it is now common for the applicants to come across representatives of the larger retail buying groups, or some of the local distributors, at carpet manufacturing plants and trade fairs overseas. This is presumably to investigate the possibility of having carpet commission-made or to establish new distributorships.
- 19.16 The accomplishments of The Carpet Barn and Robert Malcolm Carpets illustrate the ease with which players can enter quasi-manufacturing through the utilisation of “service-for-fee” providers. As well as the “service-for-fee” provider Sunrise, there is the Independent Carpet Company (Independent) also located in Melbourne. In addition to providing a complete manufacturing service, Sunrise and Independent provide carpet *finishing* on a “service-for-fee” basis for a group of manufacturers who provide “service-for-fee” tufting. Some of these manufacturers are Chaparral, Supertuft, Frontier and Combined.
- 19.17 Some of the main NZ distributors are:
- Victoria Carpets
 - Medium size Australian-based yarn and carpet manufacturer
 - Has its own sales offices in NZ and a warehouse based in Auckland
 - Distributes its own products, which are made in Australia
 - Our estimate is that it sells around [] m² per annum ([] of NZ market)
 - Carpet Barn
 - Located in Hamilton
 - Sources yarn in NZ from either Summit Wool Spinners, or Christchurch Yarns, or both
 - Has carpets commission made in Australia by Sunrise Carpets Industry Ltd
 - Our estimate is that it sells around [] m² per annum ([] of NZ market)
 - Robert Malcolm
 - Located in Christchurch
 - Sources yarn in NZ from either Summit Wool Spinners, or Christchurch Yarns, or both

- Has carpets commission made in Australia
- Also distributes for Northstate Carpet Mills, a Queensland based synthetic carpet manufacturer
- Our estimate is that it sells around [] m² per annum ([] of NZ market)

19.18 Whilst these New Zealand-based distributors may appear modest in terms of market share, they have grown and are well positioned for further growth. Any attempt to raise prices above market rate would fail. Given the straightforward process of importing, it would give some of the importers every reason to lift their import volumes to a higher level.

19.19 With the excess capacity within the industry, and the short manufacturing time cycle of carpets, we would expect the competitive response to any attempts to make supra-competitive profits to be swift.

Potential new entrants

19.20 There are a large number of international suppliers whose products are not currently in the New Zealand market that could readily be imported. Examples of these include:

- (a) Mohawk¹⁸, based in Dalton, GA, USA, and regarded as one of the world's largest floor covering manufacturer;
- (b) Weihai Shanhua Carpet Group¹⁹, headquartered in Shandong, China, and claimed to be the "strongest carpet manufacturer in China" with annual production capacity of 12 million square metres (equivalent to the size of NZ's total carpet market); and
- (c) Zhejiang Artistic Carpets Manufacturing²⁰, based in Shanghai, China, with annual production capacity of 3 million square metres.

19.21 When considering the threat of imports as a new entrant the Commission, in *Decision No. 532*, placed great emphasis on the availability of customers in order for the threat of an importer to act as a constraint. The Commission stated:

The Commission also considers that the competitive constraint imposed on the combined entity by way of threat of imports would not be weakened due to this merger. The central reason for this conclusion is that both George Weston and Goodman Fielder would be available as potential customers, overcoming a key concern on this point in *Decision 297*.²¹

19.22 As New Zealand retailers are independent and can freely choose which carpet they stock, their availability as potential customers for potential importers will remain a constraint on the existing players in the carpet market. Thus, potential new importers such as those identified in 19.20 could easily enter the market. The countervailing powers held by these retailers are further discussed in 20.

19.23 Similarly, there would not be the problems the Commission identified in *Decision No. 558*, where certain imports were found to be expensive and the competitive constraint provided by the import would be felt "...unevenly across the country".²² Carpet is relatively inexpensive to import and prices are comparable across the country.

¹⁸ www.mohawk-flooring.com

¹⁹ www.chinashanhua.com

²⁰ www.zhemeicorp.com

²¹ Para 160, ABF Overseas Limited and New Zealand Food Industries Limited

²² Para 91

Likelihood, sufficiency and timeliness of entry.

- 19.24 The applicants consider that while de novo entry by manufacturers is relatively easy, this is unlikely (other than in niche areas), given prevailing market conditions (namely relatively poor returns and the growing level of imports). New entry of imported product (either independently (that is, direct from the overseas manufacturer) or through a New Zealand agent/distributor/customer) is considered more likely, with or without the proposal.

PART V: OTHER POTENTIAL CONSTRAINTS

20. Constraints on market power by the conduct of acquirers

- 20.1 Carpet is usually sold to independent retailers who re-sell the carpet and provide an installation service. Retailers normally join buying groups, negotiating national supply terms and conditions with manufacturers and importers.²³ The industry has witnessed an increasing trend towards these buying groups or co-operatives at the retail level. This has resulted in a significant shift in the “balance of power” towards this group of very well-resourced and organised retailers and dealers who are focused on getting the very best for their group and their customers.
- 20.2 All the major retailers have established relationships with one or more offshore manufacturers (ie they are also importers in their own right), and are capable of getting carpet manufactured for them on a commission basis. They could quickly source additional supplies should the merged entity seek to increase prices.
- 20.3 One such buying group is Lincoln Capital Partners (“LCP”) – New Zealand. The majority of its retailers are Carpet Court retailers who account for [] of the volume of all Carpet Court stores put together. LCP have also recently been acquiring carpet retailers from outside the Carpet Court group. Their aim is to establish a company of significant size and market dominance that they can dictate to carpet manufacturers what the terms of trade in the future will be. We understand that discussions have been held with suppliers in both South Africa and in China. LCP’s aim is to bring in bulk overseas product to a central warehousing facility (location yet to be determined but Dunedin has been identified as an option due to the low backload rates) and then distribute to their members as well as other Carpet Court retailers. This development has the potential to significantly affect the carpet market as Carpet Court has a current retail market share of approximately [].
- 20.4 Because carpet retailers are independent, they are not obligated to (and nor do they) align themselves with any one manufacturer. Nor are they restricted from selling whatever they choose. So, support from these retailers comes down to manufacturers “being in touch with their needs”.
- 20.5 The move towards aggregation at the retail level continues to gather momentum, and there are now groups of retailers that hold considerable countervailing power over the manufacturers - not just in terms of their collective purchasing strength, but also their ability to have products commission manufactured for them if needed.
- 20.6 The applicants operate on a limited distribution basis to enable them to better manage the distribution of their products and to develop long term relationships with their retail networks. However, this has no impact on the availability of their products in the market, as the retailers have all been selected to give both the applicants the required coverage throughout the country.
- 20.7 In summary, the applicants agree with Commission’s conclusion in *Decision No. 587* that:
- ... that retailers of carpet hold a degree of countervailing power when negotiating supply terms, including prices, with manufacturers due to the ease with which these retailers, particularly the large buying groups, could switch to alternative manufacturers or to imports.²⁴

²³ *Decision No. 587*, para 33

²⁴ Para 115
1756314:AM

- 20.8 An example of retailers displaying their countervailing power was 12 years ago when Norman Ellison attempted to sell carpet direct to consumers. On doing this, retailers refused to stock Norman Ellison carpet and only returned to stocking when Norman Ellison abandoned their direct selling route.
- 20.9 This considerable countervailing power held by carpet retailers will continue to significantly constrain market players: retailers will still have a choice between New Zealand based-manufacturers and numerous imported options.

21. Other constraints

21.1 Flooring product can be broadly classified as follows:

- Soft flooring, which is carpet, and which can be further broken down into:
 - Broadloom tufted wool-rich carpet
 - Broadloom tufted wool/synthetic blended, or 100% synthetic, carpet
 - Woven wool carpet
 - Synthetic carpet tiles
 - Rugs
- Hard flooring
 - Wood
 - Ceramic tiles
 - Vinyl
 - Concrete.

21.2 As noted above, the applicants consider the correct product market to be the national carpet market. Nonetheless, there is a material level of competition from outside the market, which adds a further constraint. This is recognised on Cavalier's own web site, which describes the "Benefits Of Carpet In Your Home",²⁵ and goes on to have separate web pages to describe each of the benefits of carpet (compared to other flooring), namely: warmth, comfort, design versatility, (lack of) noise, and ease of cleaning.

THIS NOTICE is given by Victor Tan of Cavalier Corporation Limited and Russell Harding of Norman Ellison Holdings Limited. We confirm that:

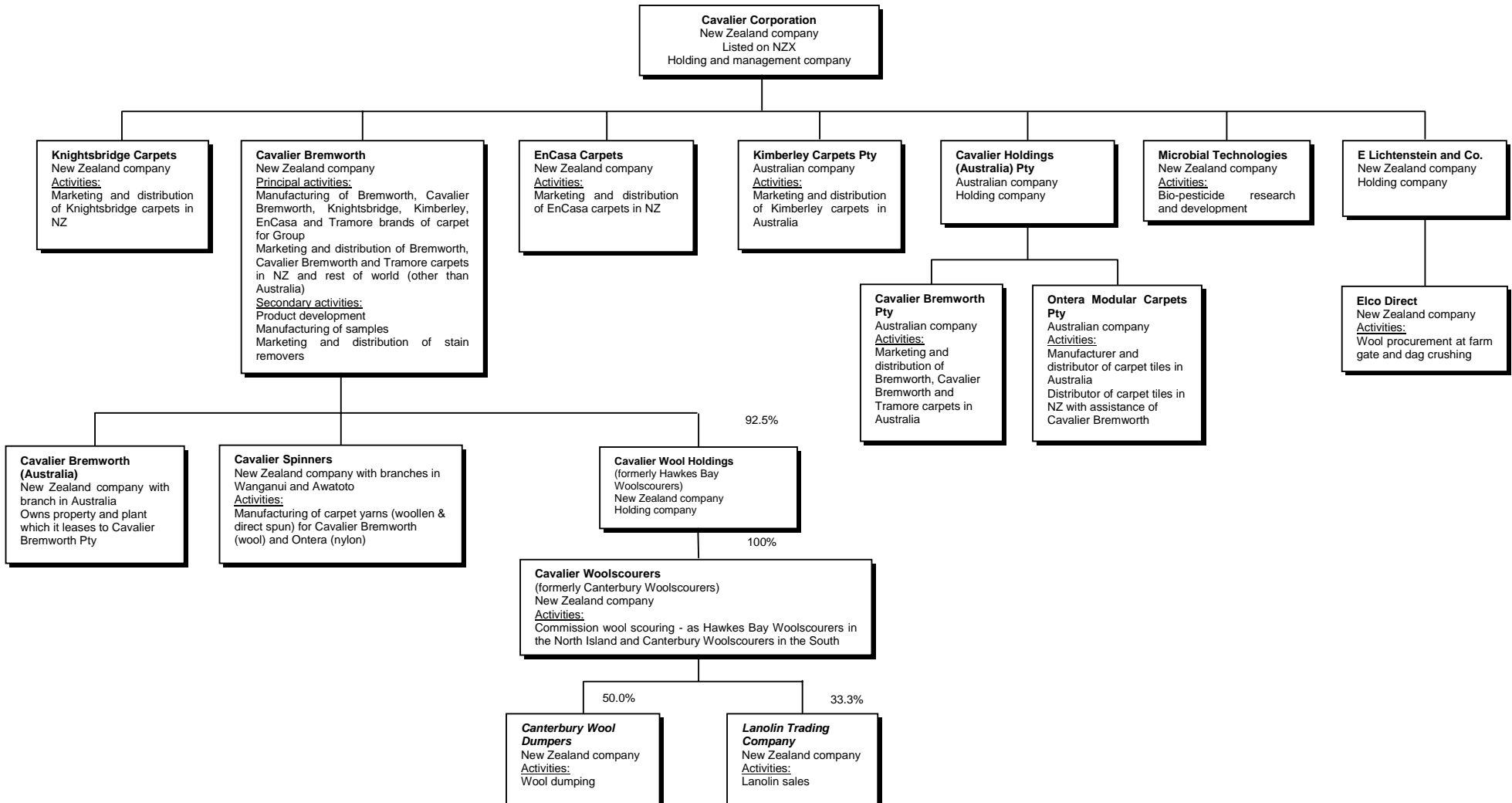
- all information specified by the Commission has been supplied; and
- all information known to the applicants which is relevant to the consideration and determination of this application/notice has been supplied; and
- all information supplied is correct as at the date of this application/notice.

²⁵ [http://www.cavbrem.co.nz/cbconsumer/home-owners/benefits-of-carpet-in-your-home/benefits-of-carpet_home\\$.cfm](http://www.cavbrem.co.nz/cbconsumer/home-owners/benefits-of-carpet-in-your-home/benefits-of-carpet_home$.cfm)

Confidential Annexure 1: [

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Annexure 2: Cavalier Corporation Limited – Group structure (operating companies only)

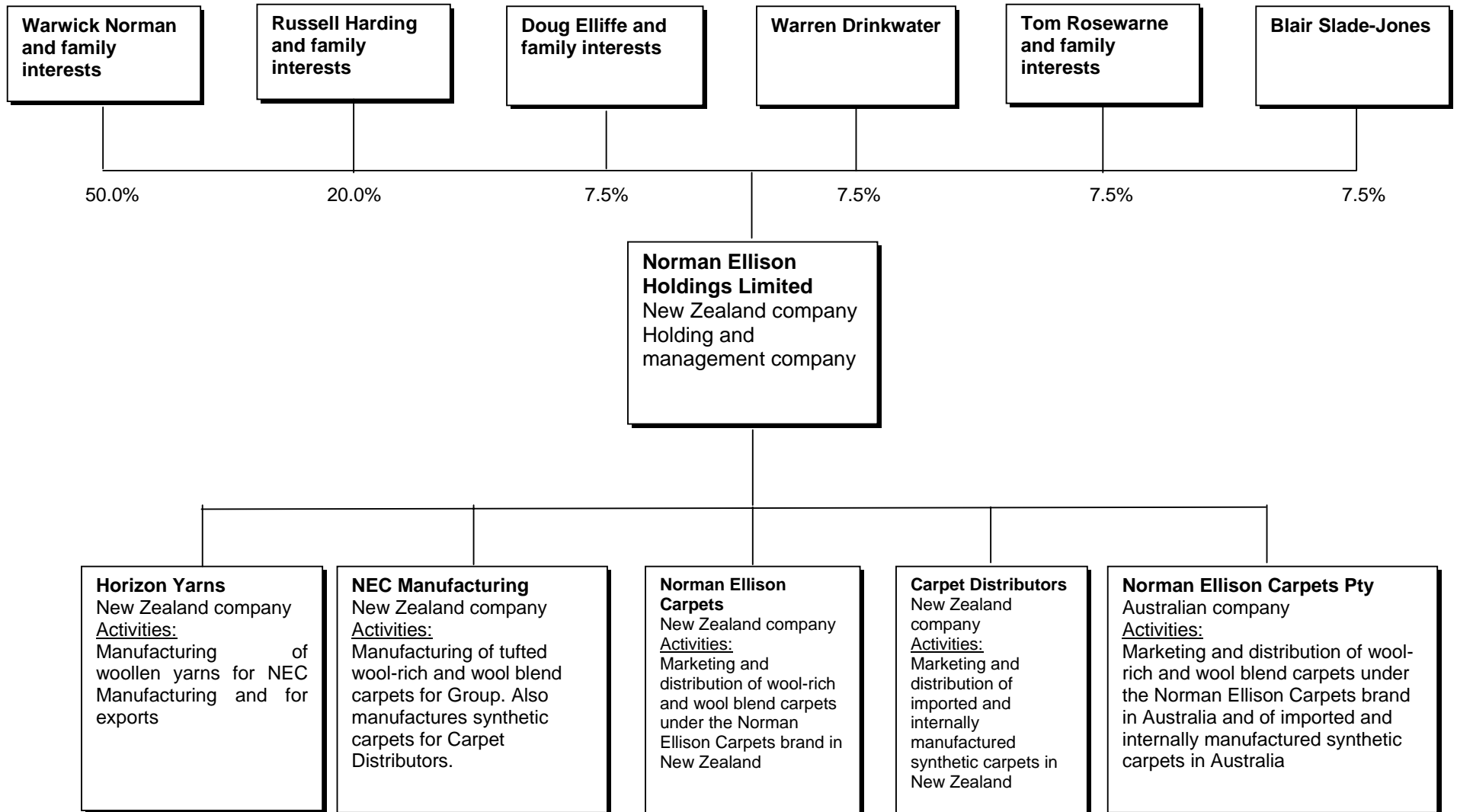


Annexure 3: Cavalier Corporation Limited – Top 20 shareholders as at 31 August 2007

<u>Name of registered shareholder</u>	<u>Shares held</u>	<u>% of total</u>
Chippendale Holdings Limited	8,886,490	13.57%
Rural Aviation (1963) Limited	8,467,642	12.93%
New Zealand Central Securities Depository Limited (NZCSD)	3,177,203	4.85%
First New Zealand Capital Custodians Limited	1,672,961	2.55%
Peter Hanbury Masfen and Joanna Alison Masfen	787,500	1.20%
Anthony Charles Timpson	420,732	0.64%
Alan Michael James and Ann White-James	373,045	0.57%
Forsyth Barr Custodians Limited	331,523	0.51%
Custodial Services Limited	322,098	0.49%
J & D Sands Limited	250,000	0.38%
Mary Dorcas Spackman	240,000	0.37%
Investment Custodial Services Limited	237,980	0.36%
Wayne Keung Chung, Colleen Linda Chung and Victor Thien Soo Tan	214,603	0.33%
Herbert Charles Wilson	204,000	0.31%
Nicolaas Johannes Kaptein	200,000	0.31%
Forsyth Barr Custodians Limited	191,449	0.29%
Custodial Services Limited	183,195	0.28%
Custodial Services Limited	161,120	0.25%
Wiedemann Trustee Limited	155,234	0.24%
Victor Thien Soo Tan, Jacintha Tan and Wayne Keung Chung	149,350	0.23%
Total shares held by top 20 shareholders	<u>26,626,125</u>	<u>40.65%</u>
Total number of shares on issue	<u>65,495,595</u>	

<u>BENEFICIAL OWNERS OF SHARES WITHIN NZCSD</u>	<u>Shares held</u>	<u>% of total</u>
Accident Compensation Corporation	1,377,889	2.10%
Guardian Trust Investment Nominees (RWT) Limited	627,674	0.96%
Citibank Nominees (New Zealand) Limited	340,146	0.52%
New Zealand Guardian Trust Investment Nominees Limited	175,555	0.27%
NZ Superannuation Fund Nominees Limited	158,484	0.24%
ANZ Nominees Limited	127,821	0.20%
National Nominees New Zealand Limited	113,300	0.17%
AMP Superannuation Tracker Fund	107,200	0.16%
TEA Custodians Limited	68,188	0.10%
Tracker Nominees – AMP Investments	35,771	0.05%
Courtney Nominees Limited	21,000	0.03%
Public Trust GIF Account # 41	16,675	0.03%
Public Trust PTIF Account # 61	7,500	0.01%
Total shares held	<u>3,177,203</u>	<u>4.85%</u>

Annexure 4: Norman Ellison Holdings Limited – Group and shareholding structure



Annexure 5: Manufacturers and distributors

Some of the New Zealand manufacturers and distributors

Godfrey Hirst	www.godfreyhirst.co.nz
Feltex	www.feltex.co.nz
Cavalier	www.cavbrem.co.nz
Norman Ellison	www.necarpet.co.nz
Autex Industries	www.aotec.co.nz
Sallee NZ	www.sallee.co.nz
Windsor Carpets	
Victoria Carpet Company	www.victoriacarpets.com.au
The Carpet Barn	www.carpetbarn.co.nz
Robert Malcolm Carpet	
Irvine International Floors	www.irvineinternational.com
Halstead Flooring Concepts	www.halstead.co.nz
Jacobsen Creative Surfaces	www.jacobsens.co.nz
Carlyle Flooring	

Some of the Australian manufacturers

Beaulieu of Australia	www.beaulieuaustralia.com.au
Chaparral Carpet Mills	
Feltex Australia	www.feltex.com.au
Godfrey Hirst Australia	www.godfreyhirst.com.au
Northstate Carpet Mills	www.northstatecarpet.com.au
Quest Carpet Manufacturers	www.questcarpet.com.au
Supertuft	www.supertuft.com.au
Tuftmaster Carpets	www.tuftmaster.com.au
Victoria Carpet Company	www.victoriacarpets.com.au
Westwools Carpets	www.westwools.com.au

Some of the non-Australasian manufacturers

Belgotex Carpets, South Africa	www.belgotex.co.za
Mohawk	www.mohawk-flooring.com
Tarkett	www.tarkett.com
Weihai Shanhua Carpet, China	www.chinashanhua.com

Some New Zealand and Australian commission providers to the market

Summit Wool Spinners, NZ	www.summitwool.co.nz
Christchurch Yarns, NZ	
Woolyarns, NZ	www.woolyarns.co.nz
Lana Spinning, NZ	
Sunrise Carpets Industry, Australia	
Independent Carpet Co., Australia	