



Carter Holt Harvey

submission to the

New Zealand Commerce Commission

on the

Preliminary Issues Paper into Residential Building Supplies

4 February 2022

Introduction

1. Carter Holt Harvey (**CHH**) is pleased to provide this response (**Response**) to the Commerce Commission's (**Commission**) preliminary issues paper (**Issues Paper**) regarding the market study into residential building supplies in New Zealand (**Market Study**).
2. Our Response is in three parts:
 - (a) the first section provides some background information about our businesses;
 - (b) the second section provides an overview of the key dynamics for the Commission to be aware of in relation to structural timber framing; and
 - (c) the third section provides responses to certain questions asked by the Commission in its Issues Paper.
3. This Response should be read by the Commission in conjunction with the information and documents that we have already provided to the Commission during the Market Study.
4. CHH looks forward to continuing to assist the Commission on its Market Study, and we are available to provide more detail to the Commission on any of the points raised in this Response.

About us

5. As the Commission is aware, CHH has two business units:
 - (a) Carters Building Supplies (Carters): Carters is a trade-focused building supplies distributor that supplies to a number of New Zealand residential and commercial trade customers. Carters has 49 wholesale distribution outlets and nine frame and truss plants located around New Zealand.
 - (b) CHH Woodproducts: CHH Woodproducts is a leading New Zealand manufacturer of structural framing, plywood, and laminated veneer lumber (**LVL**). CHH Woodproducts supplies its products to many of New Zealand's building merchants (including Carters, and many others). All of the structural timber that CHH Woodproducts produces is sold in New Zealand.
6. CHH considers that all the markets that it operates in within New Zealand are vigorously competitive, and are delivering competitive outcomes for the benefit of New Zealand consumers.
7. CHH also considers that its vertically integrated model delivers significant benefits for New Zealand consumers – including by enabling CHH Woodproducts to expand its structural framing capacity to record levels to reflect the significant increases in New Zealand house and townhouse development in recent years. Specifically, over the last five years CHH Woodproducts has invested more than \$100 million into expanding its framing timber capacity at its Kawerau and Nelson sawmills. CHH's integration with Carters has enabled CHH Woodproducts to make those investments by providing us with the confidence that we will have the required customers to justify that increased capacity.

Timber framing plays a small part in the cost of building a typical house



The cost of building a typical house in NZ (excluding land)



Structural framing timber only makes up around 2% of the total cost of building a typical house⁽²⁾

References

- (1) GST is shown as 11.2% because the modelling excludes GST from certain costs (e.g., holding costs on debt, land holding costs and finance charges).
- (2) Cost of Residential Housing Development: A Focus on Building Materials (Deloitte 2018). Land cost excluded from these estimates, which are based on the data provided for different types of houses constructed in Auckland.

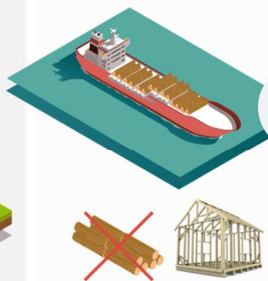
Structural framing timber is a small component of NZ's overall log harvest



36m^{m³}
logs are harvested annually
from NZ softwood plantation forests⁽¹⁾



22m^{m³}
logs are exported⁽³⁾



The vast majority of logs exported are not suitable for production of structural framing timber.

14m^{m³}
logs are consumed domestically⁽³⁾



&

3.2m^{m³}

of the 14m^{m³} logs go to structural framing timber sawmills in NZ.⁽⁴⁾



3.2 million^{m³} logs produces⁽³⁾:

1,600,000^{m³}
wood chip, sawdust and shavings

800,000^{m³}
non-framing timber

800,000^{m³}
structural framing timber

95% of structural framing timber produced in NZ is sold in NZ.⁽⁵⁾

A typical NZ new build house uses

13m³

of structural framing timber.⁽⁵⁾



Structural framing timber is a small component of NZ's overall log harvest, and

contributes around

2%

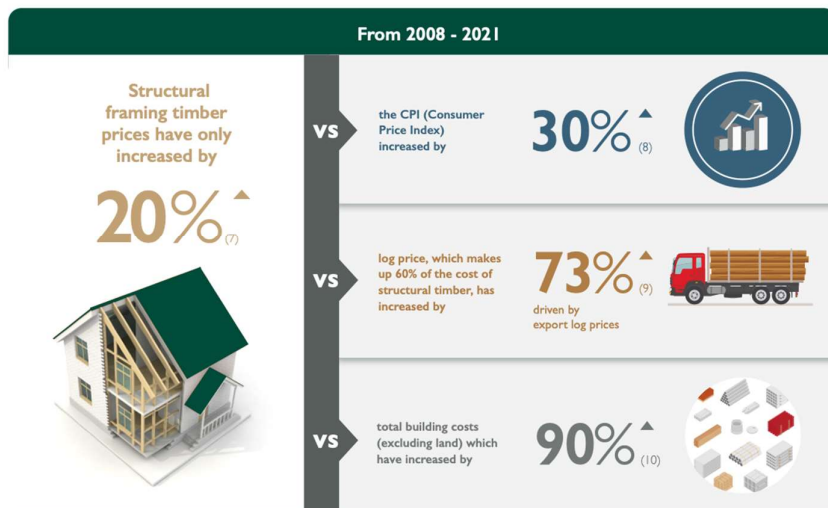
of the total cost of building a typical house.⁽²⁾

Export log price drives domestic log pricing

References

- (3) MPI 2019 data, assuming 1 tonne of log = 1 m³. 2019 figures are used due to the impact of lockdowns in 2020 and 2021.
- (4) CHH 2019 Management estimate using MPI 2019 data for all of NZ.
- (5) CHH Management estimate.

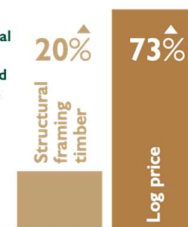
Increase in framing timber prices over 14 years in NZ⁽⁶⁾



References

- (6) The GFC and very low levels of building activity had a significant impact on timber pricing in New Zealand, so it is necessary to go back to a time period that pre-dates this. Using 2008-2021 enables a more realistic "peak-to-peak" measurement. Without doing this, the increase in framing timber pricing becomes a "trough-to-peak" measurement, which dramatically overstates the extent of the increases.
- (7) CHH sales data.
- (8) CPI All Groups from Statistics NZ Infoshare website.
- (9) CHH log cost data.
- (10) Cost of building a house sourced from Statistics NZ Infoshare website (the value of all NZ house and townhouse consents divided by the actual number of house and townhouse consents).

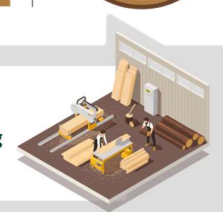
Since 2008, the price of structural timber framing has not increased at the same rate as log prices.



Log price makes up 60% of the cost of structural timber framing.



Sawmillers have absorbed significant log price and cost increases, rather than passing them on to customers.



Since 2008, structural framing timber prices have increased by 20%⁽⁷⁾, while the CPI has increased by 30%⁽⁸⁾ over the same period.

During this same period, log price, which makes up 60% of the cost of structural timber, has increased by 73%⁽⁹⁾, driven by export log prices. This means sawmillers have had to absorb a significant amount of the log price increase to compete on the domestic market.

Over the same period, total building costs (excluding land) have increased by 90%⁽¹⁰⁾.

Responses to questions in the Issues Paper

8. In addition to the information and documents that we have already provided to the Commission during the Market Study, the following provides answers to certain specific questions raised by the Commission in its Issues Paper.

Question 28: On what geographic basis (eg, local, regional, national) should we assess the concentration of key building supplies. Please explain your view.

We consider competition in the supply of key building supplies should be assessed on a national basis given freight is not an impediment to suppliers competing across New Zealand – with our experience being that suppliers of key building products typically supply their products across New Zealand.

Question 34: Are customers, (for example, merchants when purchasing from wholesalers, or builders when purchasing from merchants) able to constrain their suppliers due to their own size or negotiating position? Please explain why / why not?

Yes, merchants purchasing from wholesale suppliers, and trade customers purchasing from merchants, each have countervailing power to constrain their suppliers. For example:

- Trade customers that purchase from merchants are highly price conscious, and typically have relationships with multiple merchants that they use to shop around for the best price / terms. A customer is not beholden to a particular merchant for supply, even for an individual job, and may change merchants for different product groups, including based on price, credit terms, and proximity to a given building site. Accordingly, such trade customers have strong countervailing power.
- When merchants purchase from wholesalers, they are generally purchasing commodity products that are readily substitutable and available from other sources. Such building merchants readily change suppliers based on prices. Merchants also run RFPs to extract the most competitive possible prices from suppliers, and supply relationships are very transactional and dependent on price.

Question 35: Does vertical integration act as a barrier to entry / expansion for independent rivals? Does this differ for different building suppliers? Please explain your view.

Question 36: Is being vertically integrated necessary to compete effectively in this sector? Please explain your view.

No - vertical integration does not act as a barrier to entry / expansion, and vertical integration is not necessary to compete in the sector.

In relation to the products that CHH Woodproducts supplies, there are numerous other competitors – including many that are not vertically integrated, which demonstrates that vertical integration is neither a barrier to entry / expansion nor necessary to compete in the supply of such products.

In relation to Carters, there are a range of different building supplies merchants that offer a range of different building supplies to customers. While some of those merchants are vertically integrated, many are not. Even to the extent that Carters is vertically integrated, that is only in relation to a small subset of the products supplied via Carters. This demonstrates that vertical integration is not necessary to compete as a building merchant.

Question 37: What are the benefits in this industry to being vertically integrated? Do consumers benefit from this?

The market for the supply of structural timber is very competitive, with there being a range of different producers of structural framing timber operating 18 mills across New Zealand. Furthermore, structural timber is a commodity product that is substitutable and not specified by designers, and generally there is overcapacity in the market arising from supply exceeding demand. As a consequence, sale and purchase arrangements are very transactional as customers can choose when and where to purchase their products.

In the context of a competitive commodity market of this nature, CHH considers that its vertically integrated model delivers significant benefits for New Zealand consumers – including by enabling CHH Woodproducts to expand its structural framing capacity as demand has increased in recent years to reflect the significant increases in New Zealand house and townhouse development. Specifically, over the last five years CHH Woodproducts has invested more than \$100 million into expanding its framing timber capacity at its Kawerau and Nelson sawmills. CHH's vertical integration with Carters has enabled CHH Woodproducts to make those investments – both in manufacturing assets and innovation - by providing CHH Woodproducts confidence that it will have the required customers to justify that increased capacity. This benefits both the construction industry, and end-consumers.

Question 41: Do rebates / loyalty payments inform or restrict a merchant's or builder's decision about which product(s) to acquire? If so, how significant is this consideration?

Broadly speaking, there are two types of rebates and / or loyalty payments:

- rebates and / or loyalty payments made by merchants to trade-customers (i.e. builders); and
- end-user rebates made by manufacturers to trade-customers (i.e. builders).

Rebates and / or loyalty payments made by merchants to trade customers (i.e. builders) do not affect purchasing decisions as purchasing is transacted on a “net” price. End-user rebates made by manufacturers to trade customers (i.e. builders) can potentially inform or restrict a builder's decision about which products to purchase as they can be significant. CHH Woodproducts does not provide end-user rebates to trade customers (i.e. builders) in relation to its products, and Carters does not have visibility of the details of the end-user rebates offered by other suppliers.

Question 51: Does the current regulatory regime favour incumbent suppliers over new entrants? If so, please explain how.

CHH does not consider that the regulatory regime favours incumbent suppliers over new entrants. The purpose of the regulatory regime is to provide a safe, fit, and proper residential construction environment with minimum standards. CHH supports that purpose and considers that the regime operates effectively to achieve that purpose without favouring incumbent suppliers over new entrants.

Concluding comments

9. CHH looks forward to continuing to assist the Commission on its Market Study, and we are available to provide more detail to the Commission on any of the points raised in this Response.