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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 101/LM/Nov11

[013680]

In the matter between:

Steinhoff International Holdings Ltd	Acquiring Firm
And	
KAP International Holdings Ltd	Target Firm

Panel	:	Yasmin Carrim (Presiding Member) Medi Mokuena (Tribunal Member) Takalani Madima (Tribunal Member)
Heard on	:	30 March 2012
Order issued on	:	30 March 2012
Reasons issued on	:	15 August 2012

Reasons for Decision

APPROVAL

[1] On 30 March 2012 the Competition Tribunal ("Tribunal") unconditionally approved the acquisition by Steinhoff International Holdings Ltd of KAP International Holdings Ltd. The reasons for the approval follow below.

PARTIES TO THE TRANSACTION

[2] The primary acquiring firm is Steinhoff International Holdings Ltd ("SIH"), a public company listed on the Johannesburg Securities Exchange Ltd ("JSE"). The following shareholders held more than a 5% interest in SIH for the year ending 30 June 2011:

• Investec Asset Management	18.86%
• Public Investment Corporation	13.28%
• BS Beteiligungs und Verwaltungs GmbH	11.18%
• Eurotin SA	7.96%.

[3] SIH control various firms[1] and has a 34% shareholding in the target firm.

[4] The primary target firm is KAP International Holdings Ltd ("KAP"), a public company listed on the JSE. The following shareholders held more than a 5% interest in KAP for the year ending 30 June 2011:

• Daun & Cie AG	41.43%
• SIH	34.00%.

[5] KAP controls various firms including Feltex Automotive.[2]

ACTIVITIES OF THE PARTIES

[6] SIH is a multi-national integrated lifestyle supplier serving markets in Southern Africa, Europe and Australia. In South Africa, Steinhoff is active in a number of markets, including the supply of raw input material to furniture manufacturers. The only activity of SIH relevant for purposes of this transaction is the manufacture of flexible polyurethane foam, which it produces through its business division namely, Vitafoam.

[1] For a complete list of firms controlled by SIH see annexure A to form CC4(2) filed by the merging parties. The merging parties also submitted to the Commission that SIH had a controlling interest in Loungefoam (Pty) Ltd ("Loungefoam") but that this company ceased to trade on 01 July 2009 and sold its remaining assets to Vitafoam.

[2] See annexure 2 to form CC4(2) filed by KAP for an organogram of the firms it controls.

[7] The polyurethane foam that Vitafoam produces (called general foam) is supplied in blocks as well as in various shapes, mainly to the manufacturers of bedding, lounge suites and case goods products as raw input material into their final product. Vitafoam produces general foam at its plants in South Africa and Namibia.

[8] KAP is a listed industrial and manufacturing business with significant local manufacturing operations which has two segments, namely an industrial segment and a consumer segment. The industrial segment consists of the following:

- Industrial Footwear - produces leather protective footwear, PVC gum boots and supply bovine leather to the footwear and leather goods industries),
- Feltex Automotive - one of South Africa's largest automotive component manufacturers and manufactures moulded seat foam for use in car seats and trim components (called automotive foam) to South African Original Equipment Manufacturers ("OEMs").
- Hosaf - manufactures and distributes polyethylene terephthalate resin for the bottle and packaging market and distributes polyester staple fibre for the traditional and industrial textile sector.

[9] The consumer segment consists of the following:

- Jordan Shoes - specialises in supplying men's fashion and sports footwear mainly to the domestic markets through the entire spectrum of retailers, being credit and cash chain stores, discounters, wholesalers, mini-chains and independents
- Glodina - a towel manufacturer which provides towelling products to retailers, excluding the JD Group, and the hospitality industry;
- Bull Brand - a producer of canned and processed meat base products for the retail and informal markets throughout Southern Africa.
- Brenner Mills[3] - operates out of five factories and its outsourced distribution centres are spread over the rest of the country. Its customers

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[3] The merging parties submitted that this company is currently subject to an investigation relating to the chop market under case number 2010/Aug/5315 as well as a referral relating to white maize milling under case number 2007/Mar/2944. The merging parties further submitted

include national retail chain stores, national wholesale chain stores, private wholesales, private retailers, spaza stores as well as corner cafes.

DESCRIPTION OF THE TRANSACTION

[10] The proposed transaction is related to the SIH/JD Group transaction (the "JD Group transaction") wherein SIH is increasing its shareholding in exchange for shares in KAP. In the instant transaction, SIH intends to acquire 50% of the shares in KAP, which would increase SIH's shareholding in KAP from 34% to 88%. In exchange, KAP will acquire SIH's Industrial Assets in South Africa.[4] SIH is currently the single largest shareholder in the JD Group and it has been granted certain call options to acquire further shares in the JD Group in exchange for shares in KAP.

[11] The exercise of the call options by SIH will result in SIH's shareholding in KAP reducing from 88% to approximately 65%, whilst its shareholding in the JD Group will increase from 32.4% to more than 50%. The net effect of these transactions is that SIH will, post-merger, control KAP and the JD Group.

RATIONALE FOR THE TRANSACTION

[12] SIH submitted that this acquisition gives effect to its strategy of being an investment holding company which holds majority shareholdings in listed entities which have industrial and retail assets, but which are subject to third party inputs and controls, and are subject to extensive regulation. The merging parties further submit that SIH's strategy is to be a majority shareholder in these listed entities with a long term commitment and focus.

[13] KAP submitted that the proposed transaction represents an opportunity for it to - acquire leading industrial assets in southern Africa, complement its existing portfolio of industrial assets and establish itself as one of the largest listed industrial portfolios operating in Southern Africa. KAP also submitted that having

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that neither of these proceedings is relevant in the context of this merger, as the acquiring firm does not own or control any businesses involved in the milling of chop or bran.

[4] The Steinhoff Industrial assets include PG Bison Holdings (Pty) Ltd, Unitrans Holdings (Pty) Ltd, SHF Raw Materials and Toolplast Holdings (Pty) Ltd, which includes raw input manufacturers such as Vitafoam, BCM Holdings and DesleeMattex.

SIH as the controlling long-term shareholder will provide it with the strategic assistance to ensure its success and continued growth within the Southern Africa markets.

THE RELEVANT MARKETS AND IMPACT ON COMPETITION

[14] The Commission identified a horizontal overlap as well as a vertical relationship between the activities of the merging parties.

Horizontal Analysis

[15] Both merging parties are involved in the manufacture of flexible polyurethane foam. In defining the relevant product market the Commission identified separate product markets for the flexible polyurethane foam manufactured by Vitafoam i.e. general foam and Feltex i.e. automotive foam. The Commission found that general foam manufactured by Vitafoam is used in the furniture and bedding industry and cannot be used by OEMs in the automotive industry. On the other hand, Feltex manufactures specialised foam which is suitable for use in the automotive industry.

[16] In relation to automotive foam, the Commission found that automotive foam manufacturers such as Feltex are able to manufacture general foam for use in the furniture and bedding industry. This was confirmed by several other market participants[5] in the furniture and bedding market who informed the Commission that Feltex is capable of producing general foam for the furniture and bedding industry with its current machinery and equipment. Accordingly, the Commission identified supply side substitutability from manufacturing automotive foam to manufacturing general foam, but not *vice versa*.

[17] The Commission concluded that the relevant market is the market for the manufacture and supply of general foam for use in the furniture and bedding industry with Vitafoam and Feltex being actual or potential competitors amongst other players. It is important to note that there is an ongoing enforcement case

[5] These market participants include Strandfoam, Tuf Foam, Foaming Concepts, Uni Mattress and Greenacres.

against Vitafoam and Feltex in the polyurethane market (which will be briefly dealt with below).

[18] In relation to the geographic market, the Commission was informed by competitors of the merging parties that a correctly defined geographic market is regional and may include more than one province depending on the maximum distance that suppliers are willing to travel in order to reach their customers. The provinces indentified are Kwazulu Natal ("KZN"), Gauteng, Gauteng and KZN and KZN and the Eastern Cape. The Commission found that Feltex only has a foam manufacturing plant in KZN and supplies foam to furniture and bedding manufacturers that are situated in this geographic area. For purposes of analysing this transaction, the Commission focused on KZN as this is the narrowest geographic area in which the competitive effects of the proposed transaction are most likely to be observed.

[19] The Commission was informed by the merging parties that there are two methods used to produce general foam, namely box foam[6] plant production and continuous foam[7] plant production. The Commission found that the market participants in the KZN area namely, Vitafoam, Feltex, Uni Mattress, Tuf Foam, Foaming Concepts and Strandfoam operate continuous foam plants. The Commission submits that it excluded the box foam plant producers from its competitive assessment of this merger as it was informed by the continuous plant producers that they do not consider box foam plant producers as a significant competitive threat. Further, the Commission submits that it excluded the box foam producers as it is of the view that the continuous foam plant producers are likely to be able to meet the necessary quality and supply requirements of furniture and bedding manufacturers in KZN.[8]

[6] With this method general foam is manufactured by pouring the chemical inputs manually into a box mould. The Commission was informed that this is a low cost method of manufacturing general foam.

[7] This method involves mixing chemical inputs and pouring them automatically through a nozzle into a trough or moving conveyor.

[8] According to the Commission this exclusion does not mean that the box foam producers do not have an impact of the competitive dynamics of the market.

(i) Market shares

[20] In respect of market shares the table below shows actual production of market participants within the KZN area and those participants that have manufacturing plants located outside the KZN area but who transport general foam to this area.

Table 1: Market share calculation based on actual production volumes for KZN

Competitor	Location of manufacturing plant	Actual production (tons): 2010	Estimated market share: 2010	Actual Production (tons): 2011	Estimated Market Share: 2011
Vitafoam	Newcastle	200	2.24%	100	1.20%
Vitafoam	Durban	4,600	51.58%	3,500	42.15%
Feltex	Durban	204	2.29%	224	2.70%
Merged entity		**5,004**	**56.11%**	**3,824**	**46.05%**
Unimattress	Isithebe	2,494	27.97%	2,683	32.32%
Tuffoam	Johannesburg	1,085	12.17%	910	10.96%
Foaming Concepts	Johannesburg	75	0.84%	600	7.22%
Strandfoam	Durban	260	2.92%	285	3.43%
TOTAL		**8,918**	**100.00%**	**8,302**	**100.00%**

Source: Information collected from market participants

[21] This table shows that Vitafoam and Feltex have pre-merger market shares of approximately 43.35% and 2.70% respectively. The merged entity will therefore have an estimated market share of 46.05%, but the accretion in market share is relatively small. The Commission points out that the small market share accretion and the fact that Feltex only has a foam manufacturing plant in KZN and supplies foam to furniture and bedding manufacturers that are situated in this area may lead one to conclude that the proposed transaction does not raise competition concerns. However, as pointed above there is an on-going market allocation case against Vitafoam and Feltex in the polyurethane market. The Commission therefore assessed the effects of this alleged marker allocation on the proposed transaction.

(ii) Alleged Market Allocation

[22] The Commission referred a complaint against Vitafoam, Loungefoam (Pty) Ltd and Feltex Holdings (Pty) Ltd to us for adjudication on 25 September 2008.[9] In the referral the Commission submitted that Loungefoam and Feltex Ltd entered into an agreement in 1999 in terms of which Loungefoam acquired the furniture and bed division of Feltex Ltd, whilst Feltex Ltd retained the automotive and hi-tech divisions. According to the Commission, Clause 16 of the aforesaid agreement contained a restraint of trade clause, preventing Feltex from competing with Loungefoam in South Africa and neighbouring countries in respect of the acquired business for a period of five years. The Commission alleges that the intent and effect of this agreement was that Feltex Ltd would primarily focus on supplying polyurethane foam to the automotive industry, whilst Loungefoam would focus on supplying polyurethane foam to the furniture manufacturing industry. The Commission further alleges that notwithstanding that the aforesaid agreement terminated in 2004, its investigation has revealed that Loungefoam, Vitafoam and Feltex Ltd have continued to conduct themselves as though the 1999 agreement remains in force.

[23] The Commission also alleges that although it found that Vitafoam was not a party to the agreement between Feltex and Loungefoam, there was an understanding on its part not to compete with Feltex Ltd in supplying polyurethane foam to the automotive industry and that this was done in accordance with the agreement concluded between Feltex Ltd and Loungefoam. Furthermore, the Commission alleges that its investigation revealed that Feltex Ltd was cheating on the agreement by supplying a customer in the furniture market and this necessitated communication between Loungefoam, Vitafoam and Feltex Ltd to ensure that the terms of the market allocation agreement were complied with.

[24] Due to the various points in limine that have been raised by Vitafoam and Feltex, we have not heard nor decided on the merits of the case.

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[9] The referral was later amended to include SIH, KAP and Gomma Gomma (Pty) Ltd (see amendment reasons dated 08 June 2010, Case No: *103/CR/Sep08*.

(iii) The Counterfactual

[25] The Commission points out that the volume of general foam produced by Feltex is likely to have been limited due to the existence of this market allocation agreement and that this has the effect of masking the market share accretion that would have other prevailed. The Commission therefore submits that it is important to define the relevant counterfactual against which this merger should be assessed had there been no distortion of the general foam market conditions through the alleged market allocation agreement.

[26] The Commission's assessment of the counterfactual position started by analysing and calculating the production capacity of the general foam manufacturers. The results of this exercise are shown in the table below.

Table 1: Capacity-based market shares[10] for KZN (virgin and re-bonded foam), 2010/11

Competitor	Capacity (tons)	Market share
Vitafoam (Newcastle)	300	1.43%
Vitafoam (Durban)	8 600	40.96%
Feltex	2 000	9.53%
Merged entity	**10 900**	**51.92%**
Uni Mattress	4 500	21.43%
Tuffoam	1,274	6.07%
Foaming Concepts	4,320	20.58%

[10] The Commission submits that one of the competitors of the merging parties, namely, Strandfoam, submitted that the capacity of its manufacturing plant in Durban is 18 500 tons per annum (these figures would make Strandfoam the largest player in the KZN market). However, the Commission submits that the capacity figures of Strandfoam are not corroborated by other market participants who see Vitafoam as being the largest player. Although the Commission is of the view that Strandfoam is in a position to increase output in the event of an increase of demand or an increase in price by its competitors, the Commission submits that it is unlikely that Strandfoam would be able to produce 18 500 tons per annum due to infrastructure constraints such as warehousing space. The Commission therefore excluded Strandfoam in its market share calculations as Strandfoam's inclusion would have resulted in a decrease of the market share estimates of the merging parties and all the other general foam manufacturers.

TOTAL	**20,994**	**100.00%**

[27] This table shows that the merged entity will have a post-merger market share of approximately 52%. The Commission also assessed whether competitors of the merging parties compete from a more or less similar cost base by analysing the production costs of these firms. In this regard, the Commission found that the production costs are fairly comparable and that competitors of the merging parties are not at a significant cost disadvantage. The Commission is therefore of the view that the market position of the merged entity (under the counterfactual position) is unlikely to provide it with market power to unilaterally affect the competition condition in the general foam market in KZN.

(iv) Barriers to Entry

[28] The Commission found that the barriers to entry for the production and supply of general foam are not very high and that there has been new entry in the market. For example the Commission established that Foaming Concepts commenced trading in Gauteng in 2006, but only entered the KZN market during 2010 and was able to grow its market share in KZN by approximately 7%.

[29] The Commission also established that competitors of the merging parties have existing excess capacity and therefore it is likely that these competitors would be able to expand or increase their actual production in the event that the merged entity decided to increase the price of general foam or deteriorate product quality.

(v) Countervailing power

[30] In relation to countervailing power it is the view of the Commission that customers of general foam, i.e. furniture manufacturers, have countervailing power. This, according to the Commission, is evidenced by the fact that furniture manufacturers are able to switch between the different general foam suppliers with no or relatively little switching costs. For example Cantoni, Loungecraft Industries and Style Collections informed the Commission that they purchase general foam from different suppliers, do not incur costs when switching and can buy from different suppliers on a weekly basis. Further, The Commission submits that there is also evidence to suggest that furniture manufacturers are price

sensitive and that suppliers compete fiercely on prices[11] as illustrated by the fact that general foam manufacturers have to absorb the transport costs of the product.

(vi) Unilateral Effects

[31] According to the Commission the merged entity would not be able to exercise any form of market power to profitably increase prices or reduce output and quality of general foam. The Commission submits that any move by the merged entity to exercise market power would be constrained by the countervailing power of customers who are likely to switch to competitors of the merged entity, thereby rendering such behaviour unprofitable.

[32] Moreover, the Commission submits that this conduct is also likely to be unravelled by competitors of the merging parties who, with the excess capacity currently available in the market, will be able to expand output and offer general foam at more competitive prices than the merged entity.

(vii) Coordinated Effects

[33] As indicated above, there is an on-going enforcement case against Vitafoam and Feltex in terms of which the Commission has alleged that the two firms have entered into a market allocation strategy wherein each party undertook not to enter the market allocated to its competitor. Despite these market allocation allegations, the Commission submits that it is unlikely that the proposed transaction will result in coordinated effects as the merger does not facilitate collusion in any manner and does not materially increase the likelihood that firms in the market will successfully coordinate their behaviour or strengthen existing competition.

[34] The Commission also submits coordination is unlikely as information received from market participants suggests that the market for the supply of general foam

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[11] For example the Commission was informed by Cantoni that it has been able to play the different foam manufacturers off against each other with regards to price in the past three months. Further, Restonic, a major player in the bedding manufacturing market, informed the Commission that during the year 2011 it purchased the majority of its foam requirements from other suppliers due to the fact they had better pricing and delivery than Vitafoam.

in KZN is very competitive, customers have buying power and that the low barriers to entry are an indication that a potential entrant is likely to enter the market should the merged entity and other foam manufacturers increase their prices. Furthermore the Commission submits that the excess capacity of general foam manufacturers is likely to enable a firm not participating in the strategy to increase output and service a substantial part of the coordinating firms' customers. According to the Commission this course of action by a competitor is likely to unravel and make any form of coordination unprofitable.

Vertical Analysis

[35] The Commission identified a vertical relationship in the activities of the merging parties. In particular, the Commission analysed the following business relationships between the parties – Vitafoam's supply of foam to Jordan, supply of freight cleaning and forwarding services by Buffalo Freight Systems to Hosaf, supply of freight and logistics services to Hosaf by Unitrans and supply of rebonded foam by Feltex to Vitafoam.

[36] After analysing these relationships the Commission came to the conclusion that any attempt of foreclosure by the merged entity is unlikely as the volumes of sales supplied by each of the above firms were small and there are other firms in the market involved in the supply of these services.

THIRD PARTY VIEWS

[37] The Commission contacted third parties in order to get their views about the proposed transaction. The majority of those contacted did not have any concerns about this transaction. However, LR Foam, a customer of the merging parties, submitted that it sources one specific grade of foam from Feltex and not from any other competitor due to the high quality of this grade from Feltex. LR Foam indicated that it uses this grade of foam to manufacture mattresses for bed cots only i.e. this foam is not used by LR Foam across the board in the manufacture of beds or lounge suits. LR Foam's concern is that Feltex will, post merger, stop supplying it (due to the influence of SIH) and that it would be forced to purchase inferior products from Vitafoam at higher prices.

[38] In response the Commission submits that as this specific grade of foam is used by LR Foam for a limited product only (beds cots) it is unlikely that this will have a significant effect on competition in the broad market for furniture and bedding manufacturing. The Commission also submits that this is a pre-merger issue and that this current merger does not change situation. Further the Commission points out that this grade of foam is not being distributed by Feltex to any other furniture and bedding manufacturers. In addition, LR Foam sources other grades of foam from Vitafoam as well as from other competitors in the market.

PUBLIC INTEREST

[39] The merging parties submitted to the Commission that the proposed transaction will not have any significant effect on employment.

CONCLUSION

[40] In light of the above, we agree with the Commission that the vertical relationship between the activities of the merging parties is unlikely to give rise to any foreclosure of customers or competitors of the merging parties. Furthermore, the proposed transaction raises no public interest concerns. Accordingly we approve the transaction unconditionally.

Y CARRIM

Yasmin Carrim

15 August 2012
Date

Medi Mokuena and Takalani Madima concurring.

Tribunal researcher: Ipeleng Selaledi

For the merging parties: Heather Irvine of Norton Rose Inc.

For the Commission: Werner Rysbergen