COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 31/LM/Mar09

In the matter between:

Imperial Group (Pty) Ltd	Acquiring Firm
and	
Midas Group (Pty) Ltd	Target Firm

Panel	:	N Manoim (Presiding Member), Y Carrim (Tribunal Member) and A Wessels (Tribunal Member)
Heard on	:	26 August 2009
Order issued on	:	21 September 2009
Reasons issued on	:	12 January 2010

Reasons for Decision

Introduction

[1] On 21 September 2009 the Tribunal approved the merger between Imperial Group (Pty) Ltd and Midas Group (Pty) Ltd without conditions.[1] The reasons for approving the transaction follow below.

The transaction

[2] In terms of the transaction Imperial Group (Pty) Ltd ("Imperial") will acquire a controlling shareholding, i.e 56% of the issued share capital, in Midas Group (Pty) Ltd ("Midas"). The balance will be held by:

- Balella Investments 19%

[1] Imperial will not acquire control over the 320 Midas' franchisee retail stores , other than the fourteen company owned stores.

- Midas Investment Trust 10%
- Midas Share Trust 5%
- Major Move 101 10%

[3] Midas Group has indicated, as its rationale for the transaction, that it is seeking a large strategic investor with a similar focus to replace its, until recently, majority shareholder General Motors. It has identified Imperial Group as such an investor.

[4] Imperial states that the transaction will enable its Autoparts division, which has not made a pre-tax profit in any of the years since its inception in 2005, to develop into a sustainable business with a good geographic footprint. The transaction will also enable it to ride out the global financial crises. It intends to maintain and manage the Midas and Imperial automotive businesses as two separate brands in the market, post the transaction.

The parties

[5] Imperial, a wholesaler of auto spare parts and engine parts, is a wholly owned subsidiary of Imperial Holdings Ltd, a public company listed on the JSE Ltd. The transaction concerns four subsidiaries of Imperial namely Imperial Autoparts (Pty) Ltd ("Imperial Autoparts"), Alert Engine Parts (Pty) Ltd ("Alert"), Engine Parts Bloemfontein (Pty) Ltd ("Engine Parts") and its spare parts buying group, trading as Mikar. [2] Imperial has no retail presence.

[6] Midas, also a wholesaler of auto spare parts, operates franchised outlets of which some are company owned and some independently owned. These are:[3]

- Midas Part Centres: supplies general automotive parts
- Motolek: supplies electrical parts
- Adoc: specialises mainly in diesel parts

[2] Independent retail stores pool their purchases to secure better prices from manufacturers via Mikar. They pay a monthly fee to be part of Mikar and this gives them access to additional discounts on certain stock items on the basis of their pooled buying power. They are not obliged to purchase through Mikar. Mikar represents approximately 30% of Imperial's total sales.

[3] Midas owns 14 stores and has 234 franchisees in which it has no ownership stake. Franchisees commit to purchase 65% of their stock requirements from Midas. The franchisees represent 50% of Midas' total sales.

[7] Midas also controls a buying group consisting primarily of Midas franchisees, known as National Automobile Parts Association Ltd ("NAPA").[4]

Effect on Competition

Market definition

[8] The merging parties' activities overlap in the wholesale distribution market for aftermarket auto spares which includes engine and non-engine parts. Automotive replacement/spare parts can be divided into branded products which are manufactured by original equipment manufacturers ("OEM") and non-branded products, manufactured by non-original equipment manufacturers ("non-OEM"). OEM replacement parts are mostly used in the first four years of a vehicle's life when the vehicle is still under warranty and non-OEM replacement parts are generally used in cars older than four years. There seems to be a short transitional period where motorists might use either OEM or non-OEM spare parts in cars older than four years before completely switching to non-OEM parts. Imperial sells OEM and non-OEM manufactured spare parts while Midas only sells non-OEM spare parts.

[9] The Commission found, based on the effect of the transaction on several possible product markets ranging from a broad market for the wholesale of all non-OEM replacement parts to more narrow markets consisting only of the market for the wholesale of non-OEM engine and the market for the wholesale of non-OEM non-engine replacement parts, that the transaction would not substantially lessen or prevent competition in any of the product markets identified. It therefore opted not to conclude on a product market definition.

[10] One of the issues that the Commission considered in defining the product market was whether to include OEM products in the market definition. The Commission took several factors, as well as previous Tribunal decisions, into consideration and found that OEM suppliers did not constrain non-OEM

[4] Midas owns 52% of the shares in NAPA. The NAPA Board comprises18 individuals, of which nine are NAPA members and the rest Midas employees. NAPA has a management contract with Midas in terms of which Midas is paid a 3% Management fee for managing the NAPA business on behalf of NAPA

suppliers because OEM products are more expensive, are targeted at a different customer base and non-OEM products cannot be used in vehicles under warranty. However, it did acknowledge that there may be limited, indirect competition between OEM and non-OEM products but said that it need not decide this in light of the fact that the merger was unlikely to give rise to competition concerns whether one included or excluded OEM products from the relevant market.

[11] The merging parties agreed that OEM parts are not the primary competitive constraint on a wholesaler of aftermarket autoparts but said that it was prudent to take the competitive interaction with OEM spare parts into account in the merger analysis. The Commission however concluded that for purposes of this transaction only non-OEM aftercare products should be considered.

[12] The Commission also considered whether it was necessary to distinguish between engine parts and non-engine general automotive parts as was the case in previous Tribunal decisions. This distinction is based on the argument, which is also supported by evidence led by the merging parties that specialist knowledge is required to both purchase and sell engine parts.[5]

[13] The Marketing Shop, a market research house focusing on the automotive sector, argued in its presentation to the Commission that one should rather define the market by looking at the type of repair, thus distinguishing between a market for slow moving parts and a market for non-slow or fast moving parts.[6] The market for slow moving parts being those parts generally associated with major repair operations usually conducted by specialist repair operations, while the fast moving parts consists of the balance of products associated with scheduled maintenance and general repair for which expert sales support is not needed. According to The Marketing Shop major distributors mostly stock fast moving parts with a turnover rate of approximately three times per annum.[7]

[5] There exists specialist engine parts distributors such as Imperial's Alert Engine Parts and Engine Parts Bloemfontein businesses. Midas also sells limited stock because, as it claims, it lacks the expertise.
[6] This market definition was also supported by Autozone, a subsidiary within The Super Group, which regarded a distiction between engine and non-engine parts as artificial.
[7] See record page 789.

[14] Autozone, a subsidiary of Super Group, defined the market broadly as 'the aftermarket for replacement parts in the automotive industry', arguing that a classification into engine and non-engine parts was artificial and that no clear distinction between these two product categories existed in the market. According to it, the classification of the replacement parts market as a general spares market and an engine parts market is for convenience only and as such has no substance in the actual value chain. It divided the market into niche and specialized distributors, regional players that mainly operate in selected provinces, and finally, large national players. [8]

[15] The Commission's investigation revealed that there might be some supply-side substitution between distribution of non-OEM aftermarket engine parts and those for non-engine parts, but said that its survey showed that 72% of respondents bought engine and non-engine parts from different sources. This indicated that there may be separate markets for these products, but the Commission did not find it necessary to decided whether such a narrow market within the broader wholesale market for non-OEM replacement parts existed.

[16] With regard to the geographic market definition all the parties who had made submissions, including the Commission in its recommendation, agreed that the relevant geographic market is national. The Commission's market inquiry also revealed that some of the so-called regional distributors listed by Autozone were not confined to one particular region but that, as some of these distributors indicated, they were able and in fact did distribute their products nationally through courier services, either in-house or through third parties. This was also confirmed by their customers. According to the Commission some of the distributors, the so-called niche players, could also be classified as partial competitors of the merging parties as they supplied aftermarket engine spare parts that overlapped with the merging parties' products.

[17] As set out above the Commission investigated the competitive effect of the transaction based on a whole range of possible market definitions and found that the transaction did not lessen competition in any of these. It therefore

[8] In its submissions, which were very detailed, Autozone vigorously opposed the merger. However when the hearing before the Tribunal took place Autozone declined the opportunity to make further oral submissions.

found it not necessary to conclude on the relevant product market. The competitive impact of the transaction within the following non-OEM product markets considered by the Commission were:

1) The national wholesale distribution market for aftermarket spares,
2) The national wholesale distribution market for Engine aftermarket spares,
3) The national wholesale distribution market for Non-engine aftermarket spares,
4) The national wholesale distribution market for Non-major repair after market spares,
5) The national wholesale distribution market for Major repair aftermarket spares.

[18] We agree with the Commission's finding that it is not necessary in this case to decide whether the market should be defined as narrow or broad since the transaction would not substantially lessen or prevent competition in either case.

Competition analysis

[19] As indicated above there is a horizontal overlap in the activities of the merging parties as both parties provide non-OEM aftermarket spare parts nationally.

[20] There also exists a vertical relationship between Imperial and Midas franchisees. NGK, a company in which Imperial has a minority shareholding, supplies spark plugs to Midas and Imperial.[9] Imperial also supplies other spare parts to Midas franchisees. The Commission found that that input and customer foreclosure is unlikely as neither of the merging parties have market power downstream. There are several non-OEM spark plug manufacturers and suppliers[10] and it would be unattractive for manufacturers to conclude exclusive supply agreements with the merging parties given the low overall market share and limited direct ownership in the downstream market. Midas only owns 14 retail stores and its franchisees are not obliged to buy their

[9] The controling shareholder is NGK Japan.
[10] 65% of NGK products sold in South Africa are sold through channels other than the the merging parties.

product from the Franchisor. Switching between suppliers is also relatively easy.

[21] Since the Commission dismissed, and we agree, as unlikely, any anti-competitive effects as a result of the vertical relationships, we will focus our analysis on the horizontal effects of the transaction.

Horizontal effects

[22] The wholesale market for non-branded automotive parts in South Africa consists of rivals such as Super Group, Allparts, Replacement Parts, Gaydons, Sparepro CC and Grandmark International and a whole host of smaller players that trade from one warehouse. The large rivals that deal mainly in engine parts are EHD Components, AD Masterparts and Global Components.

[23] Wholesalers service their customers from warehouses located strategically around the country. The location of a wholesale distributors' warehouse is influenced by several factors such as the fact that demand for auto spare parts is closely correlated to the concentration of motor vehicles in an area,[11] the geographic location of the major metropolitan areas as well as the trade-off by the wholesaler between localised scale benefits and transport/logistics costs. Wholesalers with one warehouse indicated to the Commission that they supply nationally by making use of their own logistics operations, courier services or external logistics companies. Customers also indicated to the Commission that they source stock over relatively long distances, up to 600 km. The table below provides a list of the distribution coverage and warehouse locations of some of the larger competitors in the general spares and engine spare parts market:[12]

[11] 80% of demand for auto spares is in major metropolitan areas namely Johannesburg/Pretoria, Cape Town and Durban/Pietermaritzburg.

[12] The merging parties supplied this table, based on information in the Commission's recommendation, wholesalers' websites and the merging parties.

Company	Distribution coverage	Gauteng	Cape Town	Durban
Examples of general spares distributors:				
Midas	National	x	x	x
Imperial	National	x	x	x
Autozone	National	x	x	x
Gaydons	National	x		x
Sparepro	National	x	x	x
Allparts	National	x	x	x
Grandmark	National	x	x	
P & A Parts	National	x		
Diesel-Electric	National	x	x	x
Kapico	National	x		x
Danny's	National	x		
Pinnacle	National	x		x
Replacement Parts	Local (plans to go national)	x		
Argus	National	x		
Masterparts	National		x	
Kaizen	National	x		
MIT	National	x		
Examples of specialist distributors:				
AD Masterparts (engine)	National	x	x	x
EHD (engine)	National	x		
Trisome (electrical)	National	x	x	x
MED Electrical	National	x	x	x

[24] As indicated earlier distributors with only one warehouse, in some cases, indicated that they do supply nationally by either using in-house logistical services or by using the courier services offered by third parties.

[25] Based on a broad market definition the Commission calculated a total market share for the wholesale distribution of non-OEM aftermarket spares in South Africa by using actual turnovers supplied by the distributors:

Table 1: Market shares for combined national sales of non-OEM general automotive and aftermarket engine spare parts

Competitor	Market share
Midas	23%
Imperial	13%
Post merger market share	**36%**
Super Group (Autozone)	24%
Grandmark	5%
Kapiko	5%
Sparepro	3%
Gaydons	3%
Allparts	2%
AD Masterparts	2%
EHD	1%
Others	19%
Total	**100%**

[26] The merging parties estimated their market shares post the transaction as 38% in the narrow market for the distribution of non-OEM general automotive parts and 31% in the market for non-OEM engine parts. In both markets Super Group is its largest rival with a market share of 19% in the general parts market and 31% in the engine parts market.

[27] Super Group estimated in its submission to the Commission that the merging parties' market share post the transaction is approximately 60%, its own market share is estimated as 40%. It argues that only Midas, Imperial and its subsidiary, Autozone, are national players because they are vertically integrated whilst the remaining non integrated wholesalers are local players. This view is not supported by the wholesalers themselves or their suppliers

who had made submissions to the Commission, nor by the merging parties.[13] The suppliers to the wholesalers indicated that apart from the merging parties and Autozone, distributors such as Kapico, Allparts and Vally's, to name but a few, are also national players. In calculating its market share estimates Super Group also incorrectly regarded the independent Midas franchisees as Midas owned retail outlets and Imperial as having a retail presence which it does not have.

[28] Barriers to entry are significant but are not prohibitive. The Commission found that it is likely that new players will enter the distribution market by focussing on niche markets before expanding to other product lines after some time, thereby mitigating the adverse effects of economies of scale.[14] Competitors such as Sparepro CC, Allparts and Replacement parts entered as small niche players before gradually expanding into other regions and at least two smaller distributors had indicated to the Commission that they were in the process of entering or planning to enter new product markets shortly. According to Allparts it would take two to three years for a niche player to compete nationally.

[29] We also requested the Commission to investigate the effect of rebates by suppliers on the competitiveness of distributors. The Commission indicated that not all suppliers offer rebates and when they do offer them the rebates are relatively small in relation to total purchases. International suppliers rarely offered rebates. Some suppliers also indicated that they offer higher rebates to smaller players than to larger players. In most instances where suppliers did offer rebates Midas and Autozone earned the largest rebates. However it should be noted that Midas, for instance, were only offered rebates by four of its top ten suppliers of non-engine parts although Imperial got rebates from seven of its ten largest suppliers. International suppliers rarely offer rebates. Therefore, based on the evidence supplied to the Commission it seems that rebates do not seem to offer a very large price advantage to the merging parties in relation to other players.

[30] The merging parties also indicated that due to the competitive nature of the markets in which they operate the rebates that they do receive are passed on to their customers via volume and settlement discounts. The majority of

[13] See the Commission's supplementary submission dated 17 September 2009.
[14] See Commisson's recommendation page 65.

rebates which are paid to Midas' buying group NAPA are passed on to the members of the buying group. NAPA retains a small portion, approximately 1% for operating and promotional expenses.

[31] Customers of the wholesalers are known to shop around for the best prices since switching between distributors is relatively easy. This fact was also supported by suppliers. The Commission calculated diversion ratios which suggested that the price effects of the transaction is limited but it admitted that its findings were not conclusive because it was based on a relative low number of responses.

[32] The Marketing Shop suggested in its initial submission to the Commission that there had always been a perception in the market that the major wholesale distributors were colluding prior to the entry of Imperial. However the Commission could not find any such evidence and the Marketing Shop in a later statement admitted that competition within the wholesale industry was fierce and that there was currently no evidence of collusion. The Commission found that price information was not transparent and that it was difficult to monitor prices of players due to the manner in which transactions between wholesalers and retailers were conducted. It mostly took the form of a negotiated tender process as customers phoned around to get competitive prices.

[33] In light of the above we find that the transaction is unlikely to result in a substantial prevention or lessening of competition.

Public Interest

[34] The merging parties indicated that they hoped to avoid any job losses but that in a worst case scenario they anticipated a maximum of 58 job losses, i.e. 40 permanent and 18 contract employees. The merging parties pointed out that at least 40 of these job losses were not only as a result of the merger but would inevitably occur at Imperial if the proposed transaction failed, due to the worsening economic conditions. However, it is anticipated that synergies will arise from the proposed transaction principally from combining certain back-office and administrative functions which could lead to some job losses in the highly skilled and semi-skilled categories.

[35] Although the Commission recommended certain conditions in respect of employment loss which related to a contribution towards retraining, we decided not to impose such a condition. In the past the Tribunal has imposed employment conditions in transactions where it was envisaged that unskilled workers and seasonal workers would be retrenched. The purpose of these conditions was mainly to train workers in new skills in order to increase their economic value in the job market. In this transaction the parties had indicated that they intended to keep the two businesses separate thereby curtailing job losses to management levels only. Further training of these skilled workers is thus not required.

Conclusion

[36] In light of the above we find that the transaction would not substantially prevent or lessen competition. We therefore approved without conditions.

______________________ **12 January 2010**

N Manoim Date

Y Carrim and A Wessels concurring.

Tribunal Researcher:	Rietsie Badenhorst
For the merging parties:	Adv D Unterhalter SC instructed by Nortons Inc
For the Commission:	Thabelo Masithulela