COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No:71/LM/Oct06

In the matter between:

Nampak Products Limited Acquiring Firm

And

Burcap Plastics (Pty) Ltd Target Firm

Panel	:	N Manoim (Presiding Member), Y Carrim (Tribunal Member), and M Mokuena (Tribunal Member)
Heard on	:	8 December 2006 and 22 March 2007
Decided on	:	26 March 2007
Reasons Issued:		25 June 2007

Reasons for Decision

Approval

[1] On 26 March 2007, the Tribunal conditionally approved the merger between Nampak Products Limited and Burcap Plastics (Pty) Ltd. The reasons for approving the transaction follow.

The parties

[2] The primary acquiring firm is Nampak Products limited ('Nampak Products'). Nampak Products is a wholly owned subsidiary of Nampak Limited ('Nampak'), a public company listed on the JSE Securities Exchange. Nampak Products has a number of subsidiaries.[1] In addition, Nampak Products has a 50%

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[1] Nampak Products' subsidiaries include Nampak Metal Packaging Limited, Metal Box Botswana (Pty) Ltd, Metal Box Namibia (Pty) Ltd, Nampak Polycyclers (Pty) Ltd, Nampak Leasing (Pty) Ltd, Interpak Books (Pty) Ltd, Nampak Petpak Namibia (Pty) Ltd, Nampak

shareholding in Burcap Plastics (Pty) Ltd, the primary target firm in this transaction. Nampak has in excess of 100 subsidiaries worldwide.[2]

[3] The primary target firm is Burcap Plastics (Pty) Ltd, a private company duly incorporated under the laws of the Republic of South Africa. Nampak Products, the primary acquiring firm in this transaction, has a 50% shareholding in Burcap. The remaining 50% shareholding in Burcap is jointly held by the Frits Burger Family Trust ('the Burger Family Trust') and the Hans Westhof Trust ('the Westhof Trust'), with each holding a 25% share.

[4] Burcap has a 50% interest in each of Burcap Plastics Gauteng (Pty) Ltd ('Burcap Plastics Gauteng') and Burcap Plastics IML (Pty) Ltd ('Burcap Plastics IML') and the remaining 50% in each of the aforementioned companies is held by Nampak Products.

Description of the transaction

[5] Nampak currently owns 50% in Burcap Plastics (Pty) Ltd and intends to acquire the remaining 50% in this joint venture. (For convenience we will from now on refer to the businesses of Burcap (Pty) Ltd and its subsidiaries collectively as 'Burcap', except where it is necessary to make the distinction).The parties have submitted that at present Nampak and Burcap are run as separate businesses. Nampak's wholly owned subsidiary, Metal Box South Africa Limited ('MBSA'), acquired 50% in Burcap in 2000 and later ceded its 50% shareholding in Burcap to Nampak in 2004.

[6] When MBSA bought 50% in Burcap in 2000, the transaction constituted an intermediate merger and was notified for approval in terms of the Competition Act. However due to a failure of the Commission to extend its period of investigation timeously, the merger was deemed to have been approved in terms of section 14(2) of the Act. The implication is that Nampak acquired joint control by default and not a competition assessment on the merits. Thus it cannot be said that the Commission ever fully considered the competition implications of that merger.

Corrugated PMB (Pty) Ltd, Nampak Tissue (Pty) Ltd, Disaki Cores and Tubes (Pty) Ltd, Metal Box South Africa (Pty) Ltd, Printpak Limited, Amalgamated Packaging Industries (Pty) Ltd and Twinsaver (Pty) Ltd.

[2] Annexure A of the form CC4(2) filed by the primary acquiring firm.

[7] In terms of clause 6 of the shareholders agreement signed in 2000 ('the shareholders' agreement'), the incumbent management, through their chosen investment vehicles, the Burger Trust and the Westhof Trust, were given the option to put their respective 25% shareholdings in Burcap to Nampak.[3] Nampak was also given a reciprocal call option. The option was exercisable five years after the conclusion of the shareholders agreement, effectively 30 September 2006.The Burger Trust and Westhof Trust have each exercised this put option and hence the present merger.

[8] After receiving the Commission's recommendation we called for further information from the merging parties and subsequent to that asked the Commission to investigate some other aspects that arose from these new documents. The hearing of the merger was postponed on 8 December 2006 and resumed on 22 March 2007. In the interim period both the Commission and the merging parties filed further submissions. We also called a representative of one of the major customers – Mr Gwilliam, the Group Procurement Executive of Barlow Plascon South Africa ('Plascon') - to testify at the hearing when it resumed.

Rationale for the transaction

[9] Nampak has submitted that it intends to increase its shareholding in Burcap so that it can have sole control, which will enable it to better integrate Burcap into its group structure and product offering.

[10] The Burger Trust and Westhof Trust are exercising their right (in terms of a put option in the 2000 shareholders' agreement) to put their remaining 25% shareholding each in Burcap to shares to Nampak Products, the holder of MBSA rights.

The parties' activities

<u>Acquiring firm</u>

[3] Record p66.

[11] Nampak and its subsidiaries manufacture a wide variety of products which include the following:

Drums

[12] Nampak manufactures a wide range of blow moulded plastic drums. The drums come in a variety of shapes, neck formats, closure options and temper evident features. Sizes range from 1 litre to 250 litres.

Injection moulded plastic industrial containers

[13] Nampak manufactures thin wall injection moulded containers. These are small containers varying in sizes from 125grams to 1 kilogram. They are used mainly for the packaging of food in retail industry such as ice cream, yogurt and margarine. The products can be of any design or shape required, and customers can select their preference in respect of graphics, finishes and seals.

[14] Nampak also manufactures polypropylene buckets, containers, dishes, basins and reusable household containers. These containers are available from 250ml to 25 litres.

General line cans

[15] General line cans include two-piece, built up and down cans, in a variety of shapes. The general line cans are used in the following sectors: food, automotives, cosmetics, pharmaceuticals, paints and household sectors. They can be manufactured from either plastic or metal.

Metal closures

Twist off/ press twist

[16] These are the caps used to close cans and are generally used for glass jammed and processed food products. The products are offered in a wide range of sizes and have temper evident features.

Roll on Piler Proof (‘ROPP’)

[17] These include a range of aluminium ROPP closures for edible oils, wine, spirits and non-alcoholic beverages. The products are offered in a wide range of sizes with a broad selection of printing and finishing options. These are the caps used to close the bottles

Paint containers

[18] Nampak products manufactures metal paint containers in sizes of 1 litre, 5 litres and 20 litres. These containers can be used for all types of paints, including water based and acrylic based paints.

<u>The primary target firm</u>

[19] Burcap is involved in manufacturing the following products:

Injection moulded plastic industrial containers

[20] Burcap manufactures thick walled containers made of plastic. Thick wall containers are generally larger containers, where the size of the container requires a thicker wall for strength. These containers are used in food, chemicals and paint industries. They are available in sizes ranging from 100ml to 25 litres.

Paint containers

[21] Burcap manufactures plastic paint containers for water based paints in sizes of 1 litre, 5 litre and 20 litres. Burcap supplies its plastic paint containers to some of the smaller paint manufacturers Chemspec, Prominent, and Promac, amongst others,[4] but does not supply some of the largest paint manufacturers, namely, Plascon, Dulux and Medal.[5]

Relevant markets

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[4] Transcript pp 42-43.
[5] Commission's further recommendations p9.

[22] The markets implicated by this merger are difficult to define with complete precision; there are large numbers of containers of different shapes and sizes; secondly, customers range from producers of food products to producers of industrial products such as paints, and accordingly have different propensities to substitute. Whilst many manufacturers are capable of producing a range of containers, for technical reasons not all produce the complete range, and it would appear that most specialise in a particular range and further specialise in making either plastic or metal containers. Notwithstanding this array of detail, it appears that there are at least two broad segments that we can sensibly work with for purposes of analyzing the merger – containers for the food industry, typically injection moulded plastic containers, and containers for industrial products like paint, which can be either metal or plastic.

[23] With this as a basis for analysis, it means that an overlap occurs between the two merging firms in the market for containers for the food market and containers in the industrial market.

[24] With regard to the industrial containers market, the Commission had argued that the merging parties produce complementary products as one firm (Nampak) only produces metal containers, and the other (Burcap), only produces plastic containers. Metal containers are manufactured from tinplate and plastic paint containers are manufactured from polypropylene.

[25] The Commission's reasoning is based on the fact that the majority of industrial containers are sold to paint manufacturers. Hence the container choices of these customers are the primary driver as to whether plastic or metal can be considered complements or substitutes. Customer evidence is that water based paints (also called acrylic paints) can be stored in either plastic or metal containers. However, paint manufacturers prefer to store water based paints in plastic containers because the seams and welds on metal containers are vulnerable if the paint has a high water content. Plastic also does not scratch easily and has a greater after market use. Water based paints can only be stored in metal based containers if the containers are coated with a lacquer. Lacquered containers are more expensive than conventional metal based containers.

[26] On the other hand, solvent based paints (also called enamel paints) can only be stored in metal containers. At present, they cannot be stored in plastic containers because plastic is susceptible to attack by solvents.[6] For this reason the Commission came to the conclusion that the two products should be regarded as complements not substitutes.

[27] In this respect we have parted ways with the Commission and have come to the conclusion that the two technologies can be regarded as substitutes and hence are capable of disciplining one another's prices. On the evidence of the Commission's market enquiries, it is evident that at present, for some customers, plastic and metal containers are at least partial substitutes for one another.

[28] But in the near future, plastic containers will become complete substitutes for metal as new plastic technologies have been developed, presently in use in overseas markets, which will allow plastic containers to store solvent based paints, without deterioration. Yet even with the products serving as partial substitutes, as they do presently, there is evidence of a growing trend towards greater substitutability, from both customers and Nampak. Customers have advised the Commission that because plastic containers are between 15 – 20 % cheaper than their metal counterparts, where they can, they have begun substituting plastic for metal. They also inform the Commission that when one product is in short supply they substitute with the other.[7]

[29] The reason for the fluctuation in prices and supply of these container products is the cost of their respective key inputs – in the case of metal containers, steel prices which manufacturers receive from Mittal, the sole supplier in the domestic market – in the case of plastic containers, polypropylene, an input again dependant on a sole supplier, Sasol. Since these input prices are not

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[6] Plascon indicated that it puts certain solvent based products, like thinners, in plastic containers, but that it does not store solvent based paints in plastic paint. In order to store the solvents in plastic containers a process of fluorination is done on high density polyethylene containers so that there is a barrier to stop migration of that solvent over a period of time. Currently fluorination is only done by Fluoripac in Pelindaba. Fluorination is an expensive process. (Transcript p32 and p49).

[7] See for instance Earthcote, which stated that it has changed from using only tin a few years ago to tin and plastic with a saving for them of 25 -30% (record 453) Similarly, Sabre Paints says that plastic is generally cheaper, but when plastic is in short supply it makes use of metal.(Record 475)

interdependent, the gap between the prices in metal and plastic is not constant. Nevertheless customers suggest that plastic has remained the cheaper product and that the gap with metal, on most versions, fluctuates at around 20%.

[30] As a result, and where they can, firms are moving away from metal paint containers to plastic paint containers. Mr Mathontsi, the divisional managing director of one of Nampak's subsidiaries (Nampak Tubes and Tubs),admitted to this trend in his evidence:

> *"MR MATHONSI: …During a number of years the market has gradually moved its water based paint from metal containers into plastic containers. Amongst the major players in the paint market our analysis has indicated that Plascon has lagged behind in that migration from metal to plastic containers specifically for water based paints…"* [8]

Thus Nampak saw the need to defend its industrial container business, where it is the largest manufacturer of metal containers, by expanding into plastic industrial containers where it has no presence, except for its 50% interest in Burcap. The response of Nampak to this trend in substitution was threefold. The first was to use the opportunity to purchase the remaining interest in Burcap. This would give Nampak a 100% interest in a business that presently supplies, as we noted earlier, some of the plastic container needs of the paint manufacturing industry. However Burcap does not enjoy the custom of the larger players in the paint market, and most notably, it gets no business from Plascon who source all their plastic containers from another firm, Pailpac (Pty) Ltd ('Pailpac'). The reason for this is that Pailpac manufactures a container that meets Plascon's requirements, but Burcap presently does not have the technology to do so. Thus the second response of Nampak is to invest money in a plant to manufacture a container that will meet the Plascon's requirements for plastic containers for water based paint. The third response is to invest in one of the new plastic container technologies, called PET, which entails the development of a plastic container that can be used to store solvent based paints.

[8] Transcript p8.

[31] This is evidence of a dynamic market responding to changes in technology and customer needs – plastic and metal containers can no longer be considered as functionally distinct products.

[32] We can thus conclude that the relevant market comprises an overlap between the two firms in the market for injection moulded plastic containers for the food industry, and secondly, metal and plastic containers for the storage of liquids (solvent or water based) for industrial use.

Competition analysis

[33] There are no competition concerns arising from the market for injection moulded plastic containers for the food industry and in this respect we are in full agreement with the submissions of the Commission and the merging parties. Whilst the food industry requires a wide range of containers, the market is nevertheless characterised by low barriers to entry, a large number of players and high degree of supply side substitution. The merged entity will have a post merger market share of 19%. Presently, Nampak Tubes and Tubs has 9,5% and Burcap has 9,5%.[9] Apart from the merged firm there will also be at least three other companies each having a market share of approximately 14%, which will continue to compete with the merged entity. These are Pailpac with 14.1%, Polyoak (Pty) Ltd with 14.1%, and Huhtamaki (Pty) Ltd with 14.1%. In addition, there have been six new entrants into the market within the past 5 years.[10]

[34] The issues become more complex when considering the industrial containers market. Since Nampak already has 50% of the company, the merger only makes a difference if it changes the incentives of Burcap post merger. Certainly post merger, Nampak, now a 100% owner, unconstrained by its erstwhile partners, could use Burcap to protect a Nampak dominant position in metal containers or the soon to be established plastic substitutes for the metal.[11] Nampak would be able to prevent customers arbitraging between the two products, as they are presently, by raising the prices of plastic containers so

[9] Record p52.
[10] Commission's further recommendation p13-14.
[11] The remaining competitors in the metal container market are Rheem (with a market share of about 38%), Grief (with a market share of less than 2%) or Canpac (with a market share of less than 2%)

that they are priced closer to their metal counterparts and thus protect its dominant position in metal containers.

[35] Nampak, unsurprisingly, argued that it would have no such incentive, although, it did not convincingly explain why. At best it argued that customers in the face of a price rise could look to other suppliers. Firms mentioned were Pailpac (with a market share of 41%) and Markon Plastics (with a market share of 7%) and Consol Plastics (which has a market share of 2%). Pailpac has recently gained much market share and supplies some of the big paint manufacturers like Plascon and Dulux. The problem with this argument is that at present there are few other suppliers. Not only must a supplier be capable of providing the volumes and service levels required by a major customer, but it must also have the technology to make a container that meets customer's standards.

[36] It is clear from the testimony of Mr Gwilliams of Plascon, and the internal documents of Nampak which we have had access to, that those customers moving from metal to plastic, still want the latter product to meet more exacting standards. At present Plascon only sources plastic containers from Pailpac and does not procure from Burcap, because it considers that only the Pailpac product is suitable for its needs. Some smaller paint manufacturers are satisfied with the Burcap offering and use it for that purpose. However, Plascon is the most valuable customer in this sector and is particularly valuable to Nampak. [12] These presently represent sale of metal containers. It is not difficult to see how crucial the loss of some or all of this business to plastic containers would be for Nampak. Plascon, as we noted earlier does not use Burcap as a supplier for its plastic containers, because it considers that it cannot manufacture a container that meets its quality requirements. Presently, only Pailpac does and hence it supplies all Plascon's plastic container needs. Nampak for this reason took a decision to upgrade the Burcap Durban plant to meet this need. Although Nampak claims to have no guarantee that the investment will win it the Plascon plastic business, it would seem a fairly safe bet that it will. What bearing does the merger have on this investment? It seems as if the investment decision was taken once it was certain that the option would be exercised, and therefore, Nampak was at large to decide in which of the groups plants, post merger, to

[12] Plascon purchases from Nampak are three times the size of its next largest customer, in the industrial sector, Chemspec, six times larger than those of Dulux, and twice the size of its largest customer in the food sector.See record page 31

place this production. The evidence of Mr Mathonsi was that production would commence at the Burpac plant in Durban, for logistical reasons, but would thereafter continue in Gauteng at a Nampak plant.[13] However, if the merger had not gone ahead, and the status quo resumed, it is probable that Burcap would have considered winning the Plascon investment account as a viable strategy, while Mathontsi has made it clear that it intended entering this market regardless of whether the approval for this merger was granted. Although Nampak never states this explicitly it is probable that it intended this to be entry independent of Burpac and not through an investment in Burpac.[14] Thus in relation to investment in existing plastic technology to serve current needs, the merger removes the potential of separate entry for the Plascon water based plastic containers from both Burcap and Nampak and ensures that there is only a single entrant to take on Pailpac.

[37] But as we noted earlier, new technology is available to ensure that there is a viable plastic substitute for solvents. Nampak has on its own pursued this opportunity and has acquired the exclusive rights to technology to manufacture what are referred to as polyethylene terephthalate (PET) containers from an overseas firm. It would appear that this container, if successfully developed, could become the leading edge technology for this type of product. Nampak is optimistic about the prospects of the new (PET) technology because of its success in foreign markets.[15] To the best of anyone's knowledge no-one else in the domestic market has access to this technology. But once again it seems clear, that absent the merger, Burcap would have been an obvious entrant into the PET market and the merger again eliminates the potential for this conflict of interest between the two firms.

[38] Without the merger a major conflict of interest would have arisen between Burcap and Nampak. Nampak had the choice of making the new investments we have discussed, either in Burcap or independently of Burcap. Similarly, Burcap might well have viewed these projects as corporate opportunities to protect its plastics business. It is thus clear that a conflict of interest would mean that incentives between the two firms were not aligned. Burcap's

[13] See evidence of Mathonsi transcript page 22.
[14] With separate entry Nampak enjoys 100% of the returns not 50%. Since investment in this plant is de novo there was every incentive to do this at an existing Nampak plant like the one in Gauteng as synergies with the Burpac plant don't seem a consideration.
[15] See evidence of Mathonsi transcript p15-16.

management shareholders would be competing for the same corporate opportunities that Nampaks' board have identified to protect its metal container business. The merger by giving Nampak full ownership of Burcap resolves this conflict.

[39] Instead of competing for market opportunities with its half-parent, as it in all likelihood would have done, the now wholly owned Burcap will form part of a specialisation strategy in which Nampak can direct which plants do what. By eliminating Burcap as an independent entity able to make its own investment decisions, Nampak has reduced potential future competition from a firm well-placed to expand in the plastic segment of the container market. Given that only two serious players remain in the plastic segment of the market for the customers who have these needs, the merger leads to a market structure in which post merger there are two, instead of potentially three, viable competitors. Since plastic seems to be where the industrial containers market is going in the future, the elimination of even potential competition in this segment has greater implications than might seem at present. Thus, this is a market where in the language of section 12(2)(e) of the Act we must be aware of

> *"the dynamic characteristics of the market, including growth, innovation, and product differentiation."*

[40] The parties are of the view that even if there are not many players in the plastic segment of the market presently, barriers to entry are low. In this respect Mr Gwilliam of Plascon has done them a great favour. He outlined how successfully Pailpac, a firm owned by two enterprising brothers, has recently entered the market and proved highly successful. If they can do it so can someone else, the argument goes. However, Pailpac does not hold any intellectual property rights over its technology and this is the reason Nampak is investing in new plant to meet this standard without the need for a licence. What this means is that Pailpac's competitive advantage will soon be reduced as it is highly likely that Plascon will move at least some of its plastic container business to Nampak so that it is not dependent on one supplier.[16] For this reason Pailpac is in future likely to be a less vital competitor than it is presently. Since Burcap has never manufactured metal containers, the merger does not

[16] See evidence of Gwilliam on p36-37 and p42 of the transcript.

reduce the number of metal based competitors to Nampak. However, because metal containers are more expensive and are losing market share to plastic containers, firms manufacturing metal containers are unlikely to be a source of strong competitive pressure to the merging firm. To the extent that Nampak is able to raise the price of plastic containers, closer to those of metal, these firms benefit as higher plastic container prices may slow down migration from plastic to metal.

[41] We must then consider whether the merged firm will be constrained by the possibility of new entry. Superficially, barriers to entry to plastic container manufacturing appear to be low, as the success of Pailpac illustrates. Note however, this only applies to entry to manufacturing plastic containers for water based paints, their traditional use. The market must however be analysed dynamically. The market is moving towards greater use of plastic containers for both water and solvent based paints, and the firm that can provide both, is going to be able to reduce the opportunities for arbitrage between the two products, a characteristic of the market at present, and gain considerable pricing power. Since the new technology to put solvent based paints into plastic cans is dependent on access to viable patents, a barrier to entry to manufacture this product does exist. At present the only firm which enjoys access to this new technology is Nampak, via its exclusive licence to PET technology from PCC. [17] We were advised that other (PET) patents exist, but have not been licensed to anyone for exploitation in the South African market.[18] Nampak, given its size and financial strength relative to its rivals, has the ability to acquire further PET licences in order to prevent them falling into the hands of rivals or even if its does not succeed in acquiring them, by getting into a competitive auction for them, can raise the costs of the rivals who do acquire them. By acquiring control over Burcap, Nampak also gains control over another plastic container patent - the Bocan which Burcap enjoys as a result of an exclusive licence with a Danish company.

[17] In contrast, Pailpac not only does not have such a licence, but also is vulnerable to losing its present competitive advantage over its non solvent plastic containers as they are not subject to a patent and can be readily copied by a rival.

[18] The Commission and Nampak submitted that there are other patent holders worldwide which can grant licenses to other manufacturers of paint containers to manufacture PET containers. The only example provided is that of Brittpac which at one time approached Nampak with a proposal for Nampak to manufacture its PET containers. (Record pp554-557).

[42] For this reason Nampak has undertaken, as a condition for the approval of the merger, not to acquire any further exclusive licence agreements for PET paint containers within South Africa for a period of three years after the approval of this merger. [19] As Nampak has not yet developed the PET patent from PCC, a protection has been introduced in the condition in case the licence agreement is cancelled. [20]

[43] The condition states that:

> 1.1 *Save for the exclusive license agreement concluded between Nampak Products Limited and the Plastic Can Company Limited ("PCC"), neither Nampak Limited ("Nampak") nor any of its subsidiary companies may, for a period of three years from the date of approval of the proposed transaction, conclude any exclusive license agreement with any licensor for the manufacturing and sale of polyethylene terephthalate (PET) paint containers within South Africa.*
>
> 1.2 *Nampak shall after 12 calendar months from the approval of the proposed transaction, and on an annual basis thereafter and for the duration of these conditions, provide the Competition Commission ("Commission") with an affidavit deposed to by Nampak's Group Legal Adviser, confirming Nampak's compliance with paragraph 1.1 hereof.*
>
> 1.3 *Should it become apparent to Nampak at any stage during the three year period referred to in paragraph 1 above that the exclusive license agreement concluded with PCC will not result in the commercial exploitation of 1 litre and 5 litre PET paint containers manufactured under the PCC license, Nampak shall inform the Commission thereof in writing and shall provide the Commission with written confirmation of the cancellation of the exclusive license agreement concluded with PCC, before concluding any exclusive license agreement with any other licensor for the manufacturing and sale of polyethylene terephthalate (PET) paint containers within South Africa.*

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[19] See clause 1.1 of the condition

[20] See clause 1.3

[44] While the merger will in all probability result in a substantial prevention or lessening of competition in the industrial container market, the condition helps in lowering the barriers to entry in respect of new plastic technology, the direction as we observed earlier, in which the industrial container market seems to be moving. Hence other firms manufacturing paint containers will have a greater opportunity to acquire licenses to manufacture PET paint containers from other PET patent holders. This helps to ensure that rivalry with the merging firm exists in respect of all types of industrial containers.

Public Interest

[45] There are no public interest issues.

Conclusion

[46] The merger is approved subject to the tendered condition.

__________________ **25 June 2007**

N Manoim **DATE**

Tribunal Member

Y Carrim and M Mokuena concur in the judgment of N Manoim

Tribunal Researcher: R Kariga

For the merging parties: A Cockrell, instructed by Bowman Gilfillan Attorneys

For the Commission : L Blignaut and HB Senekal (linked telephonically) (Mergers and Acquisitions)