



## Statement of Issues

31 January 2013

### Gallagher Group – proposed acquisition of Country Electronics Pty Ltd

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#### Introduction

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (**ACCC**) on the proposed acquisition of Country Electronics Pty Ltd by Gallagher Group (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's Merger Review Process Guidelines (at [www.accc.gov.au/processguidelines](http://www.accc.gov.au/processguidelines)) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by **15 February 2013** and anticipates making a final decision on **14 March 2013**. However, the anticipated timeline can change in line with the Merger Review Process Guidelines. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at [www.accc.gov.au/mergersregister](http://www.accc.gov.au/mergersregister).
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

#### The parties

##### Gallagher Group

5. Gallagher is a privately owned New Zealand company involved in three key business areas with a primary focus on the design, manufacture, and marketing of the following products in New Zealand, which are exported to various countries including Australia:
  - Animal Management – electric fencing energisers and accessories, weigh scales, electronic identification readers, electric cattle prodders, animal

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handling equipment, and farm gate fittings. Gallagher Australia operates as a sales and distribution company for the Gallagher Group's animal management products in Australia;

- Security – access control products and perimeter electric fencing; and
  - Fuel Systems – petrol pumps for the oil industry.
6. Gallagher's Australian operations are carried out through a local wholly owned subsidiary, Gallagher Australia. For the purposes of this Statement of Issues, the acquirer will be referred to as "Gallagher".

### Country Electronics Pty Limited

7. Country Electronics is a privately owned manufacturer and supplier of electric fencing energisers and accessories, weigh scales, and other animal management products in Australia. It commenced operations in 1983 and sells its products under the trading name of Thunderbird.
8. Country Electronics' headquarters and manufacturing premises are located in Mudgee, New South Wales. It has three warehouses, located in New South Wales, Queensland and Victoria.
9. For the purposes of this Statement of Issues, the target, Country Electronics, will be referred to as "Thunderbird".

## Other industry participants

### Tru-Test

10. Tru-Test Corporation Limited (**Tru-Test**) is a New Zealand based manufacturer of electric fence, weigh scale and animal management products. It exports these products to a number of continents including Australia, North America and Europe, and is a major supplier of these products in New Zealand.
11. In Australia, Tru-Test supplies a number of electric fence products through three brands: Stafix, Speedrite and PEL.
12. The Gallagher Group currently owns approximately 18% of the issued shares in Tru-Test.

### Daken

13. Daken is an Australian company which supplies a range of agricultural products in Australia including electric fence products. It also manufactures and supplies tractor implements and hay making equipment. Daken is a wholly owned subsidiary of Clark Equipment Pty Ltd, a privately owned Australian company.

### Pakton

14. Pakton is an Australian Original Equipment Manufacturer (OEM) of electronics for electric fence products for animal management and security. Pakton supplies these products to other third party wholesale suppliers in Australia including Daken and JVA, as well as to overseas wholesalers.

### JVA

15. JVA is an Australian manufacturer and supplier of electric fencing products. Its electric fence energiser products are manufactured by Pakton and distributed by

a small number of rural resellers located in Queensland and Western Australia, as well as online.<sup>1</sup>

### Rural resellers

16. Most electric fencing products and animal weigh scale products are sold to end users through rural and agricultural retail stores (**rural resellers**). Market inquiries suggest that this is because most end-users seek advice about the features of the products before making a purchase.
17. Most rural resellers in Australia are part of, or members of, a larger corporate or cooperative entity, franchise or buying group. Examples of rural reseller brands in Australia include Landmark, Elders, Ruralco/CRT and Australian Independent Rural Retailers (**AIRR**). There are also some resellers who offer an online store where end-users can purchase products directly, however, the ACCC understands that sales volumes through this distribution method are currently small.
18. Market participants have indicated to the ACCC that the reseller channel is integral for the successful distribution of these products. Market inquiries indicate that the manufacturers compete to have their products stocked by the resellers by offering volume-based rebates on wholesale product purchases along with non-price offers, such as support with merchandising and after-sales service and advice.

### The transaction

19. Gallagher proposes to acquire the assets of Country Electronics Pty Limited.

### Market inquiries

20. On 25 October 2012 the ACCC commenced market inquiries regarding the proposed acquisition. A range of interested parties provided responses, including other manufacturers and suppliers of electric fencing and animal management products, retailers and agricultural industry associations.

### With/without test

21. Section 50 of the Act prohibits mergers or acquisitions that would have the effect or be likely to have the effect of substantially lessening competition in a market. In assessing a proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment if the acquisition proceeds (the “with” position) to the likely future competitive environment if the acquisition does not proceed (the “without” position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.
22. The ACCC considers that in the absence of the proposed acquisition, the status quo – that is, Thunderbird and Gallagher conducting their independent businesses – is likely to continue. The ACCC has not received any information which would suggest that, absent the proposed acquisition, it is likely that Thunderbird would either leave the market or be acquired by a different entity.

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<sup>1</sup> <http://www.jva-fence.com.au/contact.php>

## Areas of overlap

23. The ACCC considers that the following areas of overlap exist between the parties to the proposed acquisition:
- i. Electric fence products, namely electric fence energisers and accessories, which together control livestock by delivering an electric pulse through insulated fence wires. Electric fencing has the following basic components:
    - A wire or filament that carries an electric charge along the fence-line. This is the “hot”, above-ground part of the system.
    - An energiser, which can be powered by either solar, battery or mains (or sometimes more than one of these options), pushes power through the fence in a series of pulses.
    - A ground system, usually a series of metal rods sunk into the ground and connected to the energiser via a ground wire, waits dormant until the fence is touched by an animal that is also in contact with the ground. The ground system attracts the charge through the animal which completes the circuit and returns the current to the energiser.
    - Other parts, including posts, tape, insulators, reels and accessories.
  - ii. Animal weigh scale systems, which comprise an electronic weigh indicator which powers and interprets the weigh signal from load bars, and displays and stores the weight of the animal being weighed.
24. For the purposes of this Statement of Issues, electric fencing products will be referred to as ‘**energisers**’, as these are the critical component of the electric fencing products sold by the industry participants and are commonly purchased separately from other types of electric fencing products. Animal weigh scale systems will be referred to as ‘**animal weigh scales**’.

## Market definition

25. In reaching its preliminary view on the relevant markets, the ACCC had regard to the following information obtained through market inquiries.

### Product dimension

26. The ACCC considers that the merger parties principally compete in the manufacture and wholesale supply of energisers and animal weigh scales to resellers.

#### *Energisers*

27. Electric fences are typically used on rural properties in order to contain and manage livestock. There are various ways in which a rural property can be fenced. The choice of fencing generally depends on the size of the property and the types of animals to be contained. The two main types of fencing on farms are electric fencing and conventional permanent wire fencing (**conventional fencing**) or a combination of both.
28. The ACCC understands that relative to conventional fencing, electric fencing is considered by farmers to be a cost effective way of containing and managing livestock. The ACCC received information during market inquiries that conventional wire fencing costs more than electric fencing because it requires more wire and posts to make fences durable, but it requires relatively less

maintenance than electric fencing and therefore tends to be a one-off cost. Market inquiries have also indicated that in contrast to conventional fencing, electric fencing is easier to construct, more effective and versatile for containing most animals. For instance, an electric fence can be moved around a farm according to a farmer's preferences for containing animals, such as to graze in a particular paddock at a given time.

29. In light of the above factors, the ACCC's preliminary view is that there is unlikely to be a substantial level of substitution between conventional wire fencing and electric fencing.
30. Within the broader context of electric fencing products, as noted above, Gallagher and Thunderbird compete in the manufacture and supply of energisers and accessories.
31. Market inquiries have indicated that a range of general fencing accessories (such as wires, posts, reels and handles) are substitutable for products that are termed "electric fencing accessories" when constructing an electric fence. However, there are no close demand-side substitutes for the energiser component. For instance, an energiser can be purchased separately from other electric fence components and combined with them to electrify a fence. Therefore, the ACCC proposes to assess the proposed acquisition on the basis that there is a market for the supply of energisers.

#### *Animal weigh scales*

32. Animal weigh scales are used by farmers, stockyards, abattoirs and other agricultural businesses to measure an animal's weight. An animal weighing system typically involves a load bar, onto which an animal is physically placed to have its weight measured, and software that stores and analyses the weight data.
33. During market inquiries, the ACCC received information that suggests that industrial and animal scales are functionally similar, and depending on the specific products in question, prices may not be substantially different. The ACCC also received information to suggest that animal weigh scales are less expensive than industrial scales because animal weigh scales do not have to be built to the same metrology standards as industrial scales.
34. Further, the ACCC notes that animal weigh scales are manufactured as an integrated system which is suited to weighing animals. For instance, the products designed and marketed as animal weigh scales often comprise features, such as a bale or crush, which allow a user to hold an animal in place to be weighed. More sophisticated models contain features which allow users to store historical data allowing the animal's weight to be measured over time. The ACCC requires further information about the functional characteristics and prices of these products in order to reach a conclusive view on the demand-side substitutability of industrial scales and animal weighing systems.
35. With respect to supply-side substitution, market inquiries have suggested that animal weigh scales share several technical characteristics with industrial scales, and therefore that a supplier of industrial scales could deploy its capital to start supplying animal weighing systems relatively quickly and without significant expense.
36. While the ACCC will make further inquiries regarding substitution between industrial and animal scales, for the time being, the competition analysis will

proceed on the basis of a narrower market – a market for the supply of animal weighing systems.

### **Geographic dimension**

37. On the basis of market inquiries conducted to date, the ACCC considers that the appropriate geographic dimension of the market for the supply of energisers and the market for the supply of animal weigh systems is national as:
- energisers and animal weigh scales are durable products and can be transported globally. The ACCC understands that the vast majority of energisers and animal weigh scales supplied in Australia are manufactured at offshore manufacturing plants in accordance with the requisite standards and regulatory requirements such that they can be transported and sold in Australia;
  - products of all suppliers are distributed throughout Australia; and
  - market inquiries suggested that prices do not vary significantly between geographic areas.
38. Market inquiries have indicated that having a presence in the rural reseller segment is important for a manufacturer if it is to sell significant volumes of energisers and animal weigh scales to Australian consumers. Accordingly, the ACCC considers that imported sources of these products would be unlikely to competitively constrain existing suppliers in Australia, unless they had an established means of distribution such as the rural reseller channel.

### **Relevant markets – preliminary view**

39. In light of the above factors, the ACCC's preliminary view is that relevant markets for assessing whether the proposed acquisition would substantially lessen competition are:
- The manufacture and supply of animal management electric fence products (comprising electric fence energisers and accessories) in Australia; and
  - The manufacture and supply of animal management weigh scales in Australia.

The ACCC invites comments from market participants on its proposed definition of the relevant markets. In particular market participants may wish to comment on:

- (i) the substitutability of conventional wire fencing and electric fencing, including the differences in costs to farmers from using these methods;
- (ii) whether manufacturers of industrial weigh scale systems are likely to be able to quickly and profitably switch their production capacity to supply animal weigh scales in response to a (hypothetical) small but significant increase in the price of animal weigh scales; and
- (iii) the extent to which users consider industrial weigh scale systems to be substitutable for animal scales

## Market concentration

40. To date, the ACCC has been unable to obtain publicly available sources of information regarding market shares in the relevant markets to include in this Statement of Issues. Therefore, the ACCC is only able to disclose that the relevant markets are already highly concentrated. In both of the relevant markets the majority of market share is currently held by Gallagher and Tru-Test. Market inquiries have indicated that Thunderbird is the next largest competitor in terms of market share for both energisers and weigh scales. The ACCC understands that Thunderbird has a larger share of the market for energisers than it does for animal weigh scales.
41. The proposed acquisition would result in two suppliers accounting for more than 90% of sales in both of the relevant markets. In addition, Gallagher currently owns approximately 18% of the shares in Tru-Test, which may impact the extent to which the existence of Tru-Test in the market would constrain the merged firm. The smaller suppliers (for example, Daken and brands supplied by Pakton's OEM activities) do not currently have a significant presence in the rural reseller distribution channel and the ACCC understands that their market shares are currently minimal.

## Barriers to entry and expansion

42. As noted above, market inquiries have indicated that most energisers and animal weigh scales are sold to end users through the rural resellers. Therefore, the ACCC considers that being stocked by the major rural resellers is very important in order for suppliers of these products to reach a critical mass of end-users.
43. The ACCC understands that smaller suppliers of energisers and animal weigh scales have yet to gain a significant foothold in the rural reseller distribution channel. The ACCC's market inquiries indicate that resellers prefer to stock established brands and to limit the number of suppliers whose inventory they stock and sell in their retail stores.
44. Furthermore, the ACCC understands that the volume discounts and rebates offered by the suppliers to the rural resellers are likely to give the resellers an incentive to maximise sales of a particular supplier's product and reduce their willingness to stock multiple suppliers' products or switch away from the larger suppliers to stock the products of smaller competitors.
45. The ACCC's market inquiries to date have also explored the possibility that rural resellers could sponsor the entry or expansion of a smaller or new supplier of energisers or animal weigh scales. The ACCC's preliminary view is that this is unlikely, as energisers and animal weigh scales comprise only a small part of the overall sales of rural resellers. Market inquiries suggested that it was more likely that rural resellers would pass any increased prices through to their retail customers (the end users).
46. Finally, the ACCC understands that some energisers are sold by online retailers but that this is a small proportion of sales and many sales are of products manufactured by the merger parties or Tru-Test. Nevertheless, the ACCC's next phase of market inquiries will investigate whether online sales are likely to provide smaller suppliers with an alternative to the rural reseller distribution channel. The ACCC's preliminary view is that online distribution is unlikely to become an effective sales method for manufacturers of animal weigh scales in the foreseeable future.

47. In light of the above factors, the ACCC's preliminary view is that it may take a considerable period of time before a smaller competitor is in a position to expand to a point that is likely to constrain the merged entity and Tru-Test post-acquisition.
48. Nevertheless, the ACCC considers that a key issue to be explored in post-SOI market inquiries is whether another competitor, such as Daken, is likely to expand the distribution of its products and fill the position currently occupied by Thunderbird in the relevant markets, or whether the potential for new entry or expansion is a credible threat that would prevent the combined Gallagher / Thunderbird from raising prices.
49. Therefore, the ACCC seeks further information about the likelihood of smaller competitors increasing their sales through the rural reseller channel in the event that wholesale prices were to increase (or rebates to decrease), post-acquisition.

The ACCC invites comments on the potential competitive constraint likely to be imposed on a merged Gallagher/Thunderbird post acquisition in the supply of energisers and animal weigh scales. In particular:

- (i) Are the smaller suppliers of animal weigh scales, including suppliers of industrial weigh scales, likely to provide a strong competitive constraint on Gallagher and Tru-Test post-acquisition?
- (ii) Are the smaller suppliers of energisers likely to provide a strong competitive constraint on Gallagher and Tru-Test post-acquisition?
- (iii) Would rural resellers be likely to purchase significantly greater volumes of Daken or another brand of energiser or animal weigh scales to offer as an alternative to Gallagher and Tru-Test post-acquisition?
  - In what circumstances would they be likely to do so?
  - Is this likely to ensure prices return to, or remain at, pre-merger levels?
  - More generally, what are the factors that would influence a reseller's decision whether to stock a particular supplier's products?
  - Do any existing (smaller) competitors share similar characteristics as Thunderbird such that resellers could easily substitute for Thunderbird's products if prices were to increase (or if wholesale discounts were to decrease)?
- (iv) Are online sales likely to become a more significant distribution method and substitute for the rural reseller channel for smaller suppliers of energisers or animal weigh scales?

## Statement of issues

50. For the purposes of this Statement of Issues, the issues in this matter are divided into two categories, 'issues likely to raise concerns', and 'issues that may raise concerns'.

## Issues likely to raise concerns

### Energisers

51. The proposed acquisition would result in a significant increase in concentration in the market which is already very concentrated (with the majority of market share comprising Gallagher and Tru-Test). As noted above, the proposed acquisition would result in only two major suppliers accounting for more than 90% of sales and appears likely to result in muted competition relative to the present market structure.
52. The ACCC considers that the proposed acquisition may raise competition concerns as a result of the removal of Thunderbird, who appears to exert an effective competitive constraint, especially in the supply of energisers.
53. Market inquiries have suggested that Gallagher, Tru-Test and Thunderbird are currently the main suppliers of energisers in Australia.
54. Market inquiries indicate that the non-price offers of the market participants vary and that the prices of their products reflect this. For instance, Gallagher and Tru-Test supply a portfolio of energisers which vary from basic to sophisticated levels of functionality. Relative to Thunderbird, Gallagher and Tru-Test provide a high degree of sales and marketing support, including technical and after-sales support to resellers and farmers (**service offerings**).
55. With respect to the functionality of products, Thunderbird's energisers overlap with the more basic models supplied by Gallagher and Tru-Test. Market inquiries suggest that compared to most of Thunderbird's products, many of the energisers supplied by Gallagher and Tru-Test have a range of additional features, for example, LCD screens, remote controls and fence monitoring technology. The ACCC understands that the prices offered by each of the competitors in the energiser market largely reflect the differences in their product and service offerings.
56. Nevertheless, market inquiries have indicated that while Thunderbird's energisers have simpler features, they overlap in their basic functionality with most of the products offered by Gallagher and Tru-Test, and that end-users do substitute between them.
57. The ACCC's inquiries to date suggest that Thunderbird's supply of lower priced products has had a significant impact on the prices and sales of Gallagher and other competitors in the market.
58. For instance, the ACCC has obtained information which suggests that over recent years, Gallagher has decreased the prices of some of its energisers and this could be as a result of competition from Thunderbird. The ACCC's preliminary analysis of energiser prices for the last five years has confirmed that there are approximately six Gallagher energisers which are cheaper now than they were five years ago. The ACCC notes that these are products at the lower end of the functionality spectrum and all suitable for covering less than 35km, for which many customers would be likely to consider the Gallagher and Thunderbird products to be substitutable. However, this analysis is currently not conclusive.
59. The smaller suppliers such as Daken and JVA have a minimal presence in the rural reseller distribution channel and currently do not appear to provide a close competitive constraint on the three main suppliers.

60. Market inquiries have revealed very little evidence that energisers are imported in significant volumes (other than the products that have been imported by Gallagher and Tru-Test from New Zealand). Market inquiries have suggested that Gallagher and Tru-Test have been successful in Australia, despite importing energisers and animal weigh scales, because they have both established domestic distribution networks, brand recognition and have employees that are based in Australia to visit rural resellers and end users to provide services including after-sales support, advice and training. Market participants have indicated that prices would need to increase substantially before energisers would be imported directly by rural resellers or end users in significant volumes. As such, the ACCC does not consider that imports would be likely to provide an effective competitive constraint on the merged entity.
61. The ACCC is also concerned that post-acquisition, the highly concentrated market structure, together with the fact that there is common ownership between Gallagher and Tru-Test, would increase the likelihood of coordination between Gallagher and Tru-Test with respect to their product, price and service offerings in the market.
62. The ACCC is concerned that the likely effect of the proposed acquisition would be an increase in prices for various types of energisers supplied by Gallagher and Tru-Test. In particular, the ACCC considers that as a result of the proposed acquisition, there may be a reduction in competition between the manufacturers for shelf space with the rural resellers. This may take the form of an increase in the wholesale list prices and/or a reduction of the rebates offered to rural resellers, which may ultimately result in higher prices charged to end-users.
63. The ACCC understands that Thunderbird has commenced developing more powerful energisers. Therefore, the ACCC considers that the proposed acquisition may lead to a reduction in the future development of products that would be close substitutes with energiser products that are currently only supplied by Gallagher and Tru-Test in Australia. This would have the effect of significantly reducing price competition in the market relative to the counterfactual.

## **Issues that may raise concerns**

### **Animal weigh scales**

64. The ACCC understands that Thunderbird's share of the market is much less pronounced than it is in the energiser market, and market inquiries have been less clear regarding the extent to which Thunderbird competitively constrains Gallagher and Tru-Test in this market.
65. However, the animal weigh scales market is highly concentrated and the vast majority of market share is held by Gallagher and Tru-Test. In addition, Daken is not currently a supplier of animal weigh scales. Market inquiries have also indicated that due to the large size of animal weigh scales, imports by farmers or rural resellers are even less likely than they are for energisers.
66. The ACCC considers that further inquiries are required to ascertain the extent to which Thunderbird constrains Gallagher and Tru-Test in the supply of animal weigh scales.
67. Furthermore, the ACCC is considering the extent to which suppliers of industrial scales are likely to be capable of competitively constraining the merged entity. Notwithstanding this, market inquiries have indicated that access to the rural

reseller channel is also important if competitors are to meaningfully compete in the animal weigh scales market.

68. The ACCC will investigate these matters further in its next round of market inquiries.

### **ACCC's future steps**

69. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
70. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
71. Submissions are to be received by the ACCC no later than **15 February 2013**. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view in light of the issues raised above.
72. The ACCC intends to publicly announce its final view by **14 March 2013**. However the anticipated timeline may change in line with the Merger Review Process Guidelines. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.