

Anticipated acquisition by Graphic Packaging International Holding Company of Contego Packaging Holdings Limited

ME/5821/12

The OFT's decision on reference under section 33(1) given on 13 December 2012. Full text of decision published 20 December 2012.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Graphic Packaging International Holding Company (Graphic)** is a wholly owned subsidiary of Graphic Packaging Holding Company, which is listed on the New York Stock Exchange. The Graphic group is active in the supply of packaging solutions for a wide variety of products to worldwide manufacturers of food, beverage and other consumer products. In the UK, Graphic's business is focussed on the supply of cartonboard packaging products used mainly in the beverage (beer and soft drinks) segment.
2. **Contego Packaging Holdings Limited (Contego)** is incorporated in the UK and is currently a wholly owned subsidiary of Maximus Holdings II S.a.r.l, a Luxembourg entity, which in turn is owned by private equity funds.
3. Contego's carton business supplies packaging solutions primarily used in the food sector, with some specialised packaging used in the beverage (spirits) segment. In the financial year to 31 December 2011 Contego achieved turnover in the UK of £93.3 million.

TRANSACTION

4. Graphic proposes to acquire the entire issued share capital of Contego. Contego's healthcare packaging business¹ is not being acquired, but will be carved out to form a separate entity prior to the completion of this transaction.
5. Graphic submitted a Merger Notice on 16 November 2012 to the Office of Fair Trading (OFT). The statutory deadline for the OFT's decision in this case is therefore 2 January 2013.

JURISDICTION

6. As a result of this transaction Graphic and Contego will cease to be distinct. The UK turnover of Contego exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

7. The parties overlap in the manufacture and supply of folded cartonboard packaging. In particular, Graphic focuses on the supply of cartonboard packaging used for the beverage (beer and soft drinks) segment, while Contego focuses on cartonboard packaging for the food (non-beverage) sector with some sales in the beverage (spirits) sector. There is an overlap in the supply of cartonboard packaging for the non-beverage food sector; however, the increment, at less than one per cent, is minimal.

Product scope

8. The parties are both active in the supply of packaging products, and in particular the provision of folding cartonboard ² in the UK. Cartonboard

¹ Which supplies, packaging, leaflets, blister packs foils and labels to the pharmaceutical industry.

² Contego supplies cartonboard packaging products made from folding cartonboard, purchased from third party suppliers.

may be made from one of four distinct types of raw material depending on the end use of the packaging, namely:

- Recycled materials – suitable for lighter packaging for many different uses.
 - Kraft – virgin cartonboard, which is typically coated on one side and used for a wide range of purposes.
 - Virgin fibre – typically used for certain premium products.
 - Bleached cartonboard – used where high quality, premium packaging is required.
9. Cartonboard packaging can be divided into primary packaging, for example the box in which a pie is placed, and secondary packaging, for example the cartonboard box that contains bottles or cans of beer.
10. The manufacturing process, however, is similar for the different types of cartonboard packaging, and typically involves the printing, folding and gluing of pre-ordered sheets of cartonboard. For some high end uses, such as spirit cartons, the cartonboard may require ultraviolet drying, due to the large amount of inks used, and once dry, foil blocking may be applied, before the carton is cut to shape and the creases defined. In all cases the final stage of the production process is gluing, which can either be done at the manufacturing site or at the customer's site.
11. The parties submitted that cartonboard packaging is competitively constrained by from a number of other forms of packaging, such as shrink wrap, corrugated cardboard or hi-cone³ packaging.
12. The parties indicated that customers either own or rent cartonboard packing machines, with the ownership model varying by segment. This may significantly influence a customer's choice of packaging. The parties stated that Graphic's customers, who are largely in the beverage multipack (for example canned soft drinks and beer) sector, mainly rent machines from Graphic rather purchasing them. Only one customer active in the

³ Multi-packaging and plastic ring carriers of PET bottles and cans for beverages in 4, 6, 8, 12 packs.

multipack drinks segment responded to the OFT inquiries, but it confirmed that it did rent its packing machines.

13. The majority of the customers not in the multipack drinks sector responding to the OFT's inquiries indicated that they owned their own packaging machines. Customers indicated that these machines were only capable of processing cartonboard packaging and as a result none of these customers would switch to an alternative type of packaging in response to a five per cent price rise. Whereas, the multipack customer referred to above indicated that, in response to a small but significant and non-transitory increase in price (SSNIP) by a hypothetical monopolist of cartonboard, they would where feasible, from a financial, marketing and operational perspective, substitute plastic shrink film for cartonboard.
14. Therefore, on a cautious basis, the OFT has analysed this transaction on the basis of a market for folding cartonboard.

Geographic scope

15. The parties submitted that the geographic scope for the supply of folding cartonboard packaging was at least national and may well be wider.⁴ Contracts from product manufacturers were at least national in scope, and may attract interest from cartonboard packaging suppliers operating in other countries. Both parties supply cartonboard packaging from the UK to customers in continental Europe – in the case of Graphic, such exports account for eight per cent of Graphic's UK production output, and it currently has a two year pan-EU supply contract with a customer in the beverage sector. Contego also supplies cartonboard packaging to a number of pan-European customers from its plant in Leeds.
16. UK customers indicated that they currently purchase the majority (on average 95 per cent) of their cartonboard packaging from UK producers.

⁴ This is supported by the Commission's general approach to the folding cartonboard packaging market in: Case No COMP/M.5599 Amcor/Alcan of 14 December 2009; Case No Comp/M.3225 Alcan/Pechiney (II) of 29 September 2003; Case No COMP/M.3049 Alcan/Flexpack of 24 February 2003; Case No COMP/M.2840 Danapak/Teich/JV of 30 August 2002; Case No COMP/M.2843 Amcor/Schmalback-Lubeca of 28 June 2002; Case No COMP/M2.441 Amcor/Danisco/Ahlström of 11 June 2001; Case NO COMP/M.1792 Ahlström/CapMan/Folding Carton Partners of 17 January 2000.

The majority of customers that responded to the OFT's questionnaire, indicated that they would increase their use of non-UK cartonboard packaging in response to a five per cent price rise by UK producers, with another customer indicating that they would switch, where possible, to shrink wrap packaging.

17. One competitor, however, indicated that the cost of transporting empty cartonboard packaging may exceed the value of the packaging, but noted that where goods with long shelf lives for example white goods and some long life health / consumer products, for example, toothpaste and tobacco, were being made abroad, the manufacture of the packaging would follow the product. This suggests that scope for substitution away from UK cartonboard producers in response to a five per cent price rise may be limited, and as such may not be sufficient to defeat such a price rise.

Conclusion

18. Since the transaction does not raise competition concerns on any basis the OFT has not had to conclude on either the product or geographic scope, but has, on a cautious basis, analysed the transaction based on an UK market for cartonboard packaging, not segmented by end use.

HORIZONTAL ISSUES

Market Shares

19. The merged entity will have a combined share of 13.3 per cent, increment of 3.5 per cent in the supply of cartonboard packaging in the UK.

Table 1 – Overall UK market for folding cartonboard packaging – 2011

Company	Market share by value (per cent)
Graphic	3.5
Contego Carton*	9.8
Post-merger share	13.3
Chesapeake Ltd	22.0
Benson Box Holdings Ltd	11.3
Mayr Melnhof Pkg UK	6.3

Company	Market share by value (per cent)
Contego Healthcare*	5.4
Clondalkin	4.1
St Neots Packaging Ltd	3.2
Others	34.3
Total	100

Source: The parties- based upon ECMA⁵ estimate of market value of £955 million in 2011.

*Note Contego's healthcare packaging business is not being acquired and is therefore shown separately.

20. The parties submitted that they are not close competitors, with each party primarily active in producing packaging for a different type of end user. In the only product type (food packaging) where there is a direct overlap, the parties combined market share is 17.3 per cent (increment 0.5 per cent).
21. The majority of third parties indicated that they did not consider the parties to be close competitors, on the basis that they operate in different product segments.

BARRIERS TO ENTRY

22. The parties submitted that barriers to entry are relatively low, with capital spending of around £20 to £30 million required to achieve a five per cent market share of the overall folding cartonboard market. They submit that this figure is based on necessary working capital, leased premises, required machinery, and ancillary equipment. Third parties broadly confirmed the parties' estimates of the costs of entry, with one indicating that some label companies had invested in finishing equipment (gluing / folding) to produce sleeves used for ready meals etc. However, since the transaction does not raise competition concerns on any basis the OFT has not had to conclude on barriers to entry.

⁵ **ECMA**, the **European Carton Makers Association**, is the official organisation for carton businesses, national carton associations and suppliers to the carton industry. www.ecma.org

THIRD PARTY VIEWS

23. The OFT received no unsolicited comments. Third party responses have been rehearsed above as appropriate. The majority of third parties did not regard the parties as close competitors. The two customers that considered the parties close competitors either didn't use both parties, or the segment they operated in only represented a minor part of the parties' business.

ASSESSMENT

24. The parties overlap in the manufacture and supply of folded cartonboard packaging, which third parties, in the main, have indicated is a distinct market due to a lack of demand side substitution away from cartonboard, in response to a price rise.
25. The OFT considered whether the market should be narrower than all cartonboard packaging, due to a lack of demand side substitution between packaging for different end uses (for example; food and beverage packaging), but has analysed the transaction on the wider basis since the parties do not substantively overlap on any narrow basis.⁶
26. The transaction has been analysed against a UK market, since customers submitted that the majority of their cartonboard packaging was sourced from within the UK, although some third parties indicated that they might switch to suppliers located outside of the UK in response to a five per cent price rise.
27. In the market for all cartonboard packaging the parties' combined market share will be 13.3 per cent (increment 3.5 per cent), which is not at a level that unilateral effects may be expected to arise. Contego are mainly active in the cartonboard food and beverage (spirit) sectors while Graphic is mainly active in the beverage (beer and soft drink) multipack sector. In the only segment where the parties overlap, cartonboard packaging for the food segment, the parties' combined shares are 17.3 per cent, increment 0.5 per cent. The majority of third parties have indicated that as a result, they are not close competitors to one another.

⁶ See paragraph 7.

28. Third parties have confirmed that the cost of entry sufficient to gain a five per cent market share is around £20 million, with a third party identifying an episode of expansion into cartonboard by a manufacture active in a related market.
29. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

30. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.