



Public Competition Assessment

4 May 2011

Sleepyhead (a subsidiary of Wonderest Limited) - proposed acquisition of Pacific Brands' Dunlop Foams and Sleepmaker businesses; Pacific Brands - proposed acquisition of Wonderlay from Sleepyhead

Introduction

1. On 9 March 2011, the Australian Competition and Consumer Commission (ACCC) announced its decision not to oppose:
 - the proposed acquisition of Pacific Brands Limited's (**Pacific Brands**) Dunlop Foams foam business and Sleepmaker bedding business by a subsidiary of Wonderest Limited (trading as **Sleepyhead**); and
 - the proposed acquisition of Wonderest Limited's underlay business by a subsidiary of Pacific Brands.

(together, the **proposed acquisitions**).
2. The ACCC decided that the proposed acquisitions would be unlikely to have the effect of substantially lessening competition in contravention of section 50 of the *Competition and Consumer Act 2010* (the **Act**) in any relevant market in Australia.
3. The ACCC made its decision on the basis of the information provided by the merger parties and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed acquisitions, subject to confidentiality considerations.

Public Competition Assessment

4. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:
 - a merger is opposed;
 - a merger is subject to enforceable undertakings;
 - the merger parties seek such disclosure; or

- a merger is not opposed but raises important issues that the ACCC considers should be made public.
5. This Public Competition Assessment has been issued because the proposed acquisitions are considered to raise issues of interest to the public.
 6. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change.
 7. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
 8. Public Competition Assessments outline the ACCC's principal reasons for forming views on a proposed acquisition at the time the decision was made. As such a Public Competition Assessment may not definitively identify and explain all issues that the ACCC considers arise from a proposed acquisition. Further, the ACCC's decisions generally involve consideration of both non-confidential and confidential information provided by the merger parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources.

The parties

Sleepyhead (Wonderest Limited)

9. Wonderest Limited is a New Zealand registered and Australian domiciled company. In this document Wonderest will be referred to by its principal trading name, Sleepyhead.
10. Sleepyhead is a manufacturer of flexible polyurethane foam (**PU foam**), bedding and carpet underlay in Australia.

PU Foam

11. In late 2010, Sleepyhead completed building a PU foam manufacturing plant in Deer Park, Victoria. Among other uses, PU foam is used in the manufacture of bedding and carpet underlay. Sleepyhead's PU foam manufacturing plant in Victoria is capable of producing significant volumes of PU foam using carbon dioxide (CO₂) as a blowing agent. From this plant, Sleepyhead will supply the majority of its internal foam requirements for its bedding manufacturing operations. Sleepyhead will also have the ability to supply PU foam to some third parties.

Bedding

12. Sleepyhead currently operates bedding manufacturing facilities in Brisbane, Melbourne and Perth.
13. Sleepyhead supplies a full range of bedding products, including mattresses, bases and bunk beds, across different price points. The ACCC's review has focussed on mattresses as this is the key area of competitive overlap between the merger parties' operations within this product category.
14. Sleepyhead offers a range of brands including *Wonderest, Posture Perfect, Best 4 Rest* and *Sensorzone*.

Underlay – 'Wonderlay'

15. Sleepyhead manufactures PU foam carpet underlay under the 'Wonderlay' business name at its plant in Brisbane. Sleepyhead mainly supplies its PU foam carpet underlay products through sales agents to individual retail stores across Australia.

Pacific Brands Limited

16. Sleepmaker, Dunlop Flooring and Dunlop Foams are businesses of Pacific Brands Limited, which is listed on the Australian and New Zealand Stock Exchanges.

PU Foam – 'Dunlop Foams'

17. Dunlop Foams is a large manufacturer, converter and distributor of PU foam in Australia, with manufacturing and conversion plants in Brisbane, Sydney, Melbourne and Perth, and conversion only plants in Hobart and Adelaide. Dunlop Foams currently supplies foam to Dunlop Flooring's PU foam carpet underlay business and supplies all of Sleepmaker's foam requirements. Dunlop Foams also supplies significant volumes of PU foam, including specialty foam, to third parties.

Bedding – 'Sleepmaker'

18. Sleepmaker is one of the largest bedding manufacturers in Australia, with manufacturing facilities in all states except South Australia and the Northern Territory. Sleepmaker supplies mattresses across all price categories.
19. Sleepmaker's brands include *Sleepmaker, Simmons* and *Dunlopillo*.

Underlay – 'Dunlop Flooring'

20. Dunlop Flooring manufactures and supplies PU foam carpet underlay (and some rubber carpet underlay) products from its manufacturing facilities in Melbourne and Sydney. It has sales offices in each state, and supplies underlay mainly to large national customers across Australia.

ACCC review timeline

21. The following table outlines the timeline of key events in this matter.

Date	Event
01-Nov-2010	ACCC commenced review under the Merger Review Process Guidelines.
22-Nov-2010	Closing date for submissions from interested parties.
24-Nov-2010	ACCC requested further information from a party to the transaction. ACCC timeline suspended.
03-Dec-2010	Further information received from a party to the transaction. ACCC timeline recommenced.
19-Jan-2011	ACCC published a Statement of Issues outlining preliminary competition concerns.
27-Jan-2011	ACCC requested further information from a party to the transaction. ACCC timeline suspended.
04-Feb-2011	Closing date for submissions relating to Statement of Issues.
14-Feb-2011	ACCC received further information from a party to the transaction. ACCC timeline recommenced. Former proposed date for announcement of ACCC's findings of 24 February 2011, amended to allow the ACCC to consider further information requested from a party to the transaction.
9-Mar-2011	ACCC announced it would not oppose the proposed acquisitions.

Market inquiries

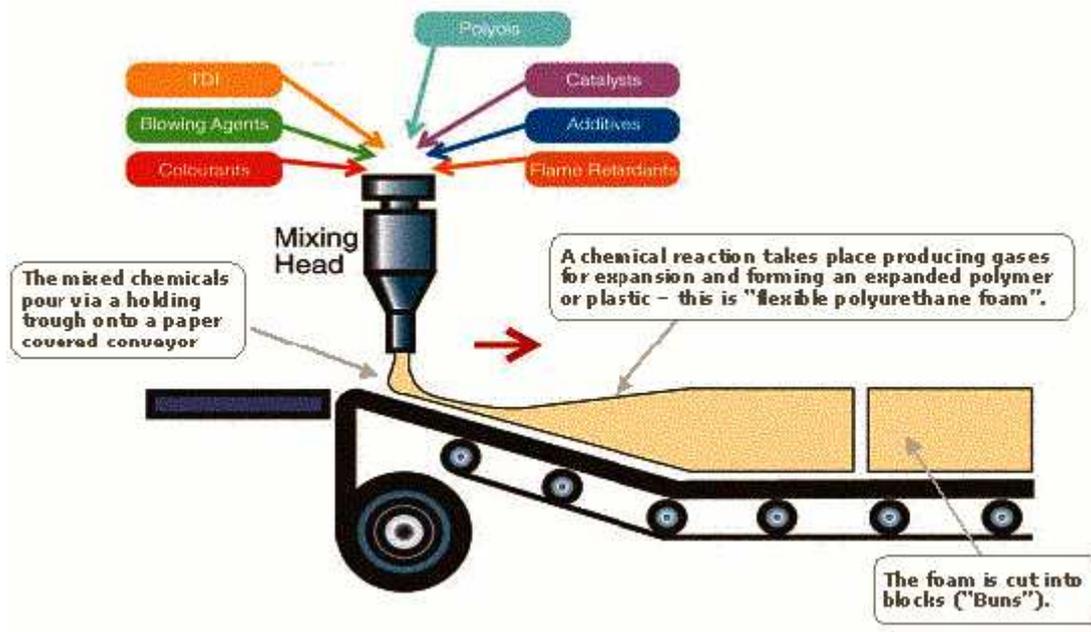
22. The ACCC conducted market inquiries with a range of industry participants, including competitors, customers, other regulatory agencies and other interested parties.

Industry Background

PU foam

23. In Australia, PU foam is produced using either the vertical or horizontal continuous slabstock foaming method or the box foaming method.
24. As displayed in Diagram 1 below, the horizontal continuous slabstock method of manufacture involves the use of a horizontal foam machine where the relevant chemical mixture is poured into an enclosed horizontal conveyor belt and expands as it travels along the conveyor belt. In contrast, the vertical continuous slabstock method of manufacture involves a vertical foam machine which pours foam that expands in a vertically upward direction.
25. Horizontal continuous foam machines are capable of producing long blocks of foam which can range from 4 to 120m³ in size.

Diagram 1: Horizontal continuous slabstock method of foam manufacture



26. Smaller PU foam manufacturers generally use the box foaming method, which involves pouring the chemical mixture into a box and allowing the foam to expand into blocks. Box foaming typically results in 4m³ blocks of foam.
27. Once expanded, PU foam blocks are converted (or cut into usable shapes and sizes) for use in downstream industries. The foam waste generated by conversion of foam ('scrap foam') is collected and used widely in the production of carpet underlay.
28. A diverse customer group consumes PU foam products. These customers include bedding manufacturers, furniture manufacturers, converters (which cut foam into different shapes and sizes for use in different applications), industries requiring specialty PU foams such as the automotive and aviation industries and consumer PU foam businesses. Consumer PU foam products primarily include bedding accessories such as pillows and simple foam mattresses.
29. There are a range of grades of PU foam produced; different grades are required by different customers in order to fulfil the functionality requirements of each customer. Grades of foam are primarily determined by the PU foam's density¹ and hardness².

Bedding

30. Sales to bedding manufacturers account for the largest proportion of domestically produced PU foam sold in Australia. PU foams which range in grades, in conjunction with latex, fibres, fabrics and springs are used in various combinations to manufacture mattresses.

¹ 'Density' is a reference to the weight of the foam in kilograms per cubic metre.

² 'Hardness' is a measure of the feel of a foam.

31. Market inquiries indicated that at the wholesale level, mattresses generally fall within the following price categories:
 - budget (\$100 - \$500);
 - low-tier (\$500 - \$1,000);
 - mid-tier (\$1,000 - \$2,000);
 - upper (\$2,000 - \$4,000); and
 - elite (\$4,000 +).
32. Brand recognition appears to be important in a consumer's choice of product, particularly in the upper price categories of bedding.
33. Market inquiries indicated that some bedding is imported into Australia, particularly bedding in the budget and elite categories.
34. Bedding is supplied to consumers via a range of national retail stores including specific bedding and furniture chain stores. Bedding is also supplied via a number of independent and franchise retail stores throughout Australia.

Underlay

35. Underlay is a thin layer of cushioning which is laid beneath carpeting, and in Australia it is generally manufactured from one of two inputs: rubber or waste PU foam. Foam underlay is made from waste PU foam and binder. The PU foam is ground into crumbs and mixed with the binder, and the resulting mix is then put into a block mould and heated, creating a solid block of rebonded foam. The blocks are then peeled into sheets and cut and wrapped into the final product.
36. Underlay is supplied to consumers via a range of national retail chain stores, franchise stores and independent stores which specialise in carpets or hardware.

Industry participants

Foam manufacturers

37. Currently, Joyce and Landfoam are the only other PU foam manufacturers in Australia (other than the merger parties) that use horizontal continuous slabstock foaming machines to manufacture PU foam.
38. Joyce is in the process of centralising all its PU foam production into one plant based in Sydney, and supplying customers nationally from this plant. Landfoam has a smaller horizontal continuous slabstock PU foam operation, supplying PU foam largely within NSW.
39. Foamco also manufactures PU foam in Australia but on a smaller scale to Joyce and Dunlop Foams and uses a vertical continuous slabstock foaming machine in its Sydney plant. Foamco also has a box foaming plant in Melbourne.

40. There are a number of other PU foam manufacturers that use the box foaming method to supply smaller volumes of PU foam in their local areas.

Bedding manufacturers

41. There are a large number of bedding manufacturers in Australia. Some, including the merger parties and their largest competitors AH Beard and Sealy, supply bedding on a national basis to bedding retailers and have manufacturing facilities across a number of states. There are numerous other bedding manufacturers throughout Australia that also supply nationally or on a more localised basis.

Underlay manufacturers

42. Bridgestone is the only manufacturer of rubber underlay in Australia and is the largest supplier of underlay in Australia. There are also a number of PU foam underlay suppliers in Australia in addition to the underlay manufacturing businesses of the merger parties (Dunlop Flooring and Wonderlay).

Statement of Issues

43. On 19 January 2011, the ACCC published its Statement of Issues regarding the proposed acquisitions in which it stated its preliminary view that the proposed acquisition of Dunlop Foams by Sleepyhead would be likely to raise competition concerns in relation to the manufacture, conversion and wholesale distribution of PU foam.
44. The ACCC also reached a preliminary view that the proposed acquisition by Sleepyhead of the Sleepmaker bedding business and the proposed acquisition by Pacific Brands of the Wonderlay underlay business were unlikely to raise concerns regarding:
- competition for the manufacture and wholesale distribution of bedding products; and
 - competition for the manufacture and wholesale distribution of carpet underlay.
45. The Statement of Issues is available on the ACCC's website at www.accc.gov.au/statementsofissues.

With/without test

46. In assessing a merger pursuant to section 50 of the Act, the ACCC must consider the effects of the proposed acquisitions by comparing the likely future competitive environment if the transaction proceeds (the "with" position) to the likely future competitive environment if the transaction does not proceed (the "without" or "counterfactual" position).

47. On the basis of market inquiries, the ACCC found that if the proposed acquisition by Sleepyhead of the Dunlop Foams and Sleepmaker businesses from Pacific Brands did not proceed, it was likely that for the foreseeable future:
- Sleepyhead was likely to continue to produce bedding and underlay, and become the main supplier of PU foam for its internal bedding and underlay businesses from its new PU foam manufacturing plant (using the continuous slabstock foaming method). Sleepyhead would also have the ability to supply PU foam to some third parties in Australia.
 - Pacific Brands was likely to continue to produce PU foam, bedding and underlay.
48. In the event that Pacific Brands does not acquire the Wonderlay business from Sleepyhead, the ACCC found that each of the parties was likely to continue to separately manufacture and supply PU foam carpet underlay for the foreseeable future.

Areas of overlap and market definition

49. The Sleepyhead and the Pacific Brands businesses subject to the proposed acquisitions currently overlap in the manufacture and distribution of carpet underlay and bedding products at the wholesale level. In the foreseeable future, the merger parties' businesses would also overlap in relation to the manufacture, conversion and wholesale supply of PU foam as a result of Sleepyhead's recently constructed PU foam manufacturing plant at Deer Park in Victoria.

PU foam markets

Product dimension

50. In identifying the scope of the product dimension of the relevant PU foam markets, the ACCC considered whether PU foam manufactured using the horizontal continuous slabstock method (which is the method adopted by both merger parties) should be treated as a distinct product market, or part of a broader product market comprising PU foam manufactured using various methods of production – particularly the vertical continuous slabstock method, and the box foaming method.
51. The ACCC's preliminary view expressed in the Statement of Issues was that PU foam producers who use the vertical continuous slabstock and box foaming method of manufacture should be included in the relevant market, but may nevertheless provide limited competitive constraint on PU foam producers using the horizontal continuous slabstock method. This view was based on limited information provided to the ACCC at that time that suggested that PU foam produced using the horizontal continuous slabstock method of manufacture is capable of producing a wider range of grades of PU foam and would generally result in PU foam of a higher quality and consistency than PU foam produced using either the vertical continuous slabstock or the box foaming method.

52. Following the release of the Statement of Issues, the ACCC made extensive market inquiries in relation to this issue. The ACCC obtained more comprehensive information which indicated that in fact, most machinery types used to produce PU foam are technically able to produce a full range of foam grades. It was however noted that there may be limits on the ability to produce high grades of PU foam with densities over 30kg/m³ using vertical continuous slabstock machinery. Nevertheless, given this limitation relates only to one type of machinery and the average density of foam sold in Australia is within the capability of vertical continuous slabstock machinery, the ACCC considered that it was appropriate to define the product dimension of the market to include PU foam produced for non-specialised purposes using all methods of manufacture.
53. Although the ACCC recognised that non-specialised PU foam is appropriately characterised as falling within the same product market, the level of competitive constraint provided by different manufacturers was found to vary in response to a range of different factors. These factors are elaborated on in the availability of substitutes section below.
54. The ACCC also considered whether the product dimension of the relevant PU foam markets should include the manufacture and supply of specialty PU foam. Dunlop Foams currently supplies various types of specialty PU foam. The ACCC considered that each type of specialty PU foam is only required by a specific customer group and customers are unable to substitute between specialty PU foam and other PU foam. Further, production of the various types of specialty PU foam requires specific equipment, expertise, research and development and conversion facilities. Accordingly, the ACCC took the view that specialty PU foams are unlikely to be within the same market as PU foam produced for non-specialised purposes. The ACCC considered it unlikely that Sleepyhead would supply specialty PU foam in the absence of the proposed merger. Consequently, the ACCC has not considered the proposed acquisition of Dunlop Foams by Sleepyhead in the context of the supply of specialty PU foams.

Geographic dimension

55. In the Statement of Issues the ACCC expressed its preliminary view that the manufacture and supply of PU foam appears to be evolving from state-based geographic markets into a national market. Key reasons for this included:
 - improvements in compression technologies which have increased the ability for PU foam to be compressed, lowering the costs of transportation and reducing the possibility of PU foam damage in transit; and
 - evidence of centralisation of PU foam manufacturing facilities in order to achieve economies of scale in production in response to decreasing volumes of demand for PU foam in Australia.
56. The ACCC noted that Dunlop Foams currently supplies customers in most states from its manufacturing plants located in the same state. It manufactures PU foam in its facilities located in Victoria, New South Wales, Queensland and Western Australia and operates conversion facilities to supply customers in South Australia and Tasmania.

57. In contrast, Joyce, the other major supplier of PU foam, is in the process of centralising all PU foam manufacture into one plant based in Sydney, and supplying nationally from this plant. The ACCC noted that Joyce has been supplying into Victoria since 2003, without a manufacturing presence in Victoria. Joyce has conversion plants in each state where it supplies PU foam.
58. The ACCC concluded that the geographic market is currently more suitably characterised as being state-based. Market inquiries following the Statement of Issues continued to indicate that although there are examples of the geographic market tending towards a national market, there is also evidence which indicates that competition for a larger number of PU foam customers occurs primarily on a state-wide basis (and in some instances, between neighbouring states).
59. Market inquiries indicated that it is important that PU foam suppliers maintain a presence in the states where their customers are located in order to satisfy many customers' just-in-time delivery requirements. The ACCC recognises that although PU foam suppliers are increasingly electing to manufacture PU foam in fewer locations, customers' just-in-time delivery requirements can generally be satisfied in states where a manufacturer does not pour foam through the use of conversion only facilities. Market participants indicated that PU foam suppliers without a local presence in the state of a particular customer are at a competitive disadvantage compared to suppliers with a local presence proximate to that customer.
60. On this basis, the ACCC considered that the geographic markets for the manufacture, conversion and wholesale distribution of PU foam are appropriately defined as state-based markets. While the ACCC considered the relevant PU foam markets are likely to still be state-based, the ACCC recognises that these markets may be trending towards a national market. The ACCC noted that whether the relevant geographic market boundaries were defined on a state or national basis, this would not have impacted on the ACCC's decision in relation to this matter.

Bedding market

61. Market inquiries conducted subsequent to releasing the Statement of Issues confirmed the ACCC's preliminary view that one of the relevant markets for the purpose of examining this matter was a national market for the manufacture and wholesale distribution of bedding products.
62. As outlined in the Statement of Issues, the ACCC noted that there are some differences between bedding in each price category such as:
 - quality of components: bedding in lower price ranges uses lower quality threading in fabrics, lower density PU foams and less exotic fabrics; and
 - quantity of components: bedding in lower price ranges uses fewer springs and less PU foam.

63. However, market inquiries indicated that bedding manufacturers are generally able to switch to manufacturing bedding at different price ranges with relative ease, given that the machinery and inputs used are similar across different price ranges. Accordingly, the ACCC took the view that bedding in all price categories should be considered to fall within the same market.
64. Market inquiries indicated that the appropriate geographic market for the manufacture and wholesale distribution of bedding products is national, given that supply contracts are predominantly arranged on a national basis with national retailers. National retailers represent a significant proportion of bedding customers. Further, bedding manufacturers appear to set the prices of their products nationally. Accordingly, the ACCC considered that the geographic dimension of the market for the manufacture and wholesale distribution of bedding was national.

Carpet underlay market

65. Market inquiries conducted subsequent to releasing the Statement of Issues confirmed the ACCC's preliminary view that the relevant markets for the purpose of examining this matter included the national market for the manufacture and wholesale distribution of carpet underlay.
66. As outlined in the Statement of Issues, market inquiries indicated that wholesale and downstream customers are likely to consider PU foam underlay and rubber underlay to be close substitutes, given the similar pricing, functionality and technical specification of the two types of underlay. Accordingly, the ACCC's view was that the relevant market for carpet underlay includes underlay made from PU foam, and underlay made from rubber.
67. Market inquiries indicated that manufacturers of underlay are able to supply underlay throughout Australia from one manufacturing facility. Accordingly, the ACCC considered that the geographic market for the manufacture and wholesale distribution of underlay was national.

Conclusion

68. Based on the above considerations the ACCC formed the view that the relevant markets in which to consider the proposed acquisitions are:
 - state-based markets for the manufacture, conversion and wholesale distribution of PU Foam;
 - the national market for the manufacture and wholesale distribution of bedding products;
 - the national market for the manufacture and wholesale distribution of carpet underlay.

Competition analysis

PU foam markets

69. The ACCC outlined preliminary concerns in the Statement of Issues about the impact of the proposed acquisition of Dunlop Foams by Sleepyhead on competition for the manufacture, conversion and wholesale distribution of PU foam. In particular, the ACCC identified preliminary concerns that the proposed acquisition of Dunlop Foams by Sleepyhead would be likely to result in a substantial lessening of competition in the national market for the manufacture, conversion and wholesale distribution of PU foam on the basis that it would remove Sleepyhead as a likely vigorous and effective competitor in this market.
70. Following information received in response to the Statement of Issues, the ACCC revised this preliminary view and concluded that the proposed acquisition of Dunlop Foams by Sleepyhead is unlikely to result in a substantial lessening of competition in state-based markets for the manufacture, conversion and wholesale distribution of PU foam. Information received from the merger parties as well as other market participants indicated that, in recent years, the relevant PU foam markets have experienced increased levels of competition as a result of falling demand for PU foam and competitors' drive to gain sufficient volumes from remaining customers by competing on price. The ACCC considered that it is unlikely that in the absence of the proposed acquisition of Dunlop Foams, Sleepyhead would have materially changed the level of competition in the markets. The relevant factors are discussed further below.

Market concentration

71. Dunlop Foams is the largest manufacturer of PU foam across most states in Australia. Joyce also has a strong presence across all states in Australia, although not to the same extent as Dunlop Foams. Foamco supplies PU foam in a range of states in Australia, however Foamco's presence focuses on New South Wales and Victoria. In the absence of the proposed acquisition of Dunlop Foams by Sleepyhead, the ACCC considered that Sleepyhead would have the ability to supply PU foam to various customers in a number of different states.

Availability of substitutes

72. The ACCC found that alternatives to the products of the merged firm were available. However, some firms were likely to provide more competitive constraint than others.
73. The ACCC found that in addition to price, PU foam customers generally focus on the following factors in determining which suppliers may be able to supply their PU foam requirements:
- **quality** – the consistency (lack of variation in density and hardness) between foam grades as well as the ability to produce PU foam within technical specifications and without flaws. The ACCC found that the quality of PU foam produced by manufacturers may vary and is not necessarily determined by the method of manufacture employed by the manufacturer. Market

inquiries indicated that different manufacturers produce different quality PU foams based on a range of factors, including technical expertise and quality of raw materials;

- **service** – the ability to provide a reliable delivery service to customers with short turnaround (just-in-time) requirements, including for certain larger customers, the ability to supply the same grades of PU foam nationally; and
 - **range** – the ability to produce a range of PU foam grades which satisfy a customer’s specifications and overall requirements. For certain larger customers the ability to meet substantial volume needs and produce a range of foams was an important aspect in choosing a PU foam supplier.
74. Market inquiries indicated that Joyce would continue to provide strong competition to the merged entity in terms of the price, quality, service and range requirements of PU foam customers. In addition, market inquiries indicated that Foamco, the third largest manufacturer of PU foam, was likely to provide a significant price constraint on Dunlop Foams and Joyce for the supply of PU foam supplied to price-conscious customers in the states in which it operates.
75. The ACCC found that PU foam manufacturers supplying foam in a single state generally provide a material, but lesser competitive constraint on larger competitors including Dunlop Foams and Joyce, in the states in which they operate.

Market dynamics

76. The ACCC received information from a range of sources, including internal information and documents from the merger parties, third party PU foam manufacturers and industry reports which indicated increasing levels of competition in the relevant PU foam markets.
77. Market inquiries indicated that a key driver for increased levels of competitive tension between existing PU foam manufacturers, including large manufacturers, is declining industry demand which has impacted the volume of PU foam produced and consequently, the scale at which suppliers operate. The volume of PU foam acquired in Australia has fallen from over 30,000 tonnes per annum in the year 2000 to less than 25,000 tonnes per annum currently. This fall in demand appears to be largely the result of increased imports of downstream products that incorporate PU foam, primarily furniture products, but also bedding products.
78. The downward trend in demand has exacerbated existing excess capacity in the industry with the result that in recent years, there has been increased intensity of price competition between suppliers as they attempt to retain or grow their customer base to sustain their operations.

Removal of Sleepyhead as a potential vigorous and effective competitor

79. In the Statement of Issues the ACCC outlined its preliminary view that in the absence of the proposed acquisition of Dunlop Foams by Sleepyhead, Sleepyhead's entry may result in three large manufacturers of PU foam (Dunlop Foams, Joyce and Sleepyhead), while the proposed acquisition of Dunlop Foams by Sleepyhead would reduce the number of possible competitors in the PU foam market in the foreseeable future from three to two.
80. The ACCC also posed its preliminary view that:
- (i) even if Sleepyhead does not supply third parties, the imminent threat of it doing so was likely to act as a competitive constraint, impacting on pricing and improving non-price conditions of supply of PU foam; and
 - (ii) the commencement of self supply by Sleepyhead as a vertically integrated manufacturer of PU foam would result in the removal of Sleepyhead as a large PU foam customer in the market, increasing the levels of excess capacity which may result in increased competition between Dunlop Foams and Joyce to gain market share amongst a smaller pool of customers.
81. In response to the Statement of Issues, as well as on the basis of information and documents obtained from the merger parties and other market participants, the ACCC received further information which caused it to revise the preliminary views outlined above.
82. Further market inquiries confirmed that in the absence of the proposed acquisition of Dunlop Foams by Sleepyhead, Sleepyhead would have the ability to supply PU foam to certain customers, in particular those customers that are currently supplied by either Dunlop Foams, Joyce and/or Foamco. However, market inquiries also showed that with or without the proposed acquisition of Dunlop Foams by Sleepyhead, the level of competition in the relevant PU foam markets was unlikely to be materially different because:
- PU foam markets have experienced increased levels of competition as a result of declining demand for PU foam. Based on information obtained by the ACCC, it was considered unlikely that, in the absence of the proposed acquisition of Dunlop Foams by Sleepyhead, Sleepyhead would have materially changed the level of competition in the markets; and
 - market inquiries indicated that Sleepyhead would be likely to achieve only a modest level of third party sales in the absence of the proposed acquisition of Dunlop Foams by Sleepyhead. This is because a number of potential bedding PU foam customers indicated that they were unwilling to support Sleepyhead because it is a downstream competitor to their bedding manufacturing business.

83. The ACCC considered that Sleepyhead's entry into the foam markets (whether it entered as a supplier to third parties, or limited its activities to self supply providing an imminent threat of entry) was unlikely to materially change the level of competition in these markets in the foreseeable future. The ACCC considered that Sleepyhead was unlikely to become a competitive force in the foam markets in the absence of Sleepyhead's proposed acquisition of Dunlop Foams. The primary reasons behind this decision are the existing levels of price-based competition in the market and the disinclination expressed by a number of potential customers as to their willingness to obtain supply of PU foam from Sleepyhead.

Barriers to entry

84. The ACCC considered information which suggested that barriers to entry in the PU foam markets are likely to be high. Key reasons for this are:
- PU foam markets in Australia are characterised by significant excess production capacity. A number of existing foam manufacturers can theoretically meet the total domestic demand for foam through their business alone, therefore a new entrant is likely to fear incumbents deploying excess capacity against it;
 - the downward trend in demand has exacerbated the oversupply of production capacity – this has the result that potential new entrants that do not have significant internal foam requirements to support such an investment are likely to face difficulties justifying entry solely on the basis of targeting third party supply. Further, new entrants are likely to face difficulties securing market share given the significant excess capacity of incumbent producers. In recent years, it appears that there has been increased competitive intensity to secure foam volumes amongst incumbent players; and
 - the sunk costs associated with investing in PU foam manufacturing plants (compliant with environmental protection agency requirements) and the time required to build a customer base of the minimum efficient scale necessary to justify such an investment is likely to deter potential new entry, in the absence of a vertical integration strategy such as Sleepyhead's.

Countervailing power

85. Market inquiries did not reveal any evidence that customers in the PU foam markets would be likely to sponsor new entry or vertically integrate into PU foam production, as Sleepyhead has done. In light of the current market dynamics previously outlined, the ACCC considered that customers in the PU foam market would be unlikely to vertically integrate into PU foam production or be in a position to sponsor new entry. Accordingly, the ACCC took the view that customers did not have sufficient countervailing power to competitively constrain PU foam suppliers in each of the PU foam markets.

Conclusion

86. The ACCC concluded that the level of competition in the relevant PU foam markets is unlikely to be materially different with or without the proposed acquisition of Dunlop Foams by Sleepyhead. Notwithstanding high barriers to entry and the lack of countervailing power on behalf of PU foam customers to bypass PU foam suppliers, the ACCC had regard to information which strongly indicated that levels of competition between existing PU foam suppliers have increased in recent years in response to falling volumes of PU foam demand. In particular, the ACCC considered the existing level of competitive constraint which would continue to be provided to the merged firm by Joyce as well strong price-based competition provided by Foamco for certain categories of customer. In light of these factors, the ACCC found that the loss of Sleepyhead as a potential additional source of supply was unlikely to have a substantial impact on competition in the relevant markets.
87. Accordingly, the ACCC formed the view that the proposed acquisition of Dunlop Foams by Sleepyhead would not be likely to result in a substantial lessening of competition in state-based markets for the manufacture, conversion and wholesale distribution of PU foam.

Bedding market

88. The ACCC considered that following the proposed acquisition of Sleepmaker by Sleepyhead there is unlikely to be a significant increase in the level of concentration in the national market for bedding products. Further, the merged entity would be likely to be competitively constrained by a number of existing competitors such as Sealy and AH Beard, who are able to increase production in response to any increase in price by the merged firm.
89. Accordingly, the ACCC considered that the proposed acquisition of Sleepmaker by Sleepyhead is unlikely to result in a substantial lessening of competition in the national market for the manufacture and wholesale distribution of bedding products.

Carpet underlay market

90. Sleepyhead currently manufactures and distributes PU foam carpet underlay from its manufacturing plant in Brisbane. The ACCC considered that the proposed acquisition of the Wonderlay underlay business by Pacific Brands would result in a small increase in market concentration in this market. However, the merged firm was likely to be competitively constrained by existing domestic competitors, particularly Bridgestone, a major manufacturer of rubber underlay, as well as competition from imports.
91. Accordingly, the ACCC considered that the proposed acquisition of the Wonderlay underlay business by Pacific Brands is unlikely to result in a substantial lessening of competition in the national market for the manufacture and wholesale distribution of carpet underlay.

Conclusion

92. On the basis of the above analysis, the ACCC concluded that the proposed acquisitions would be unlikely to have the effect of substantially lessening competition in contravention of section 50 of the Act.