



Public Competition Assessment

11 February 2019

Thales S.A. - proposed acquisition of Gemalto N.V.

The ACCC's decision

1. On 20 December 2018, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition of Gemalto N.V. (**Gemalto**) by Thales S.A.¹ (**Thales**) (the **proposed acquisition**), following the acceptance of a section 87B divestiture undertaking.²
2. The divestiture undertaking requires Thales to sell its global GP HSM business to a purchaser approved by the ACCC.
3. The ACCC considered that the proposed acquisition, taking into account the divestiture undertaking, would not be likely to contravene section 50 of the *Competition and Consumer Act 2010* (the **Act**).
4. Section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.
5. The ACCC focused its investigation on the markets for the supply of general purpose (**GP**) hardware security modules (**HSM**) and payment HSMs in Australia.
6. The ACCC considered that as Thales and Gemalto were each other's closest competitors and the two largest suppliers of GP HSMs worldwide and in Australia, the proposed acquisition would likely lead to a substantial lessening of competition without the divestiture undertaking.
7. Please note that this and other public competition assessments are subject to the following qualifications:
 - The ACCC considers each transaction on a case-by-case basis and so the analysis and decision outlined in one assessment will not necessarily

¹ The proposed acquisition involves the subsidiary Thales Australia Holdings Pty Ltd.

² Merger parties can provide the ACCC with a court-enforceable undertaking under section 87B of the *Competition and Consumer Act 2010* to remedy competition concerns identified by the ACCC.

reflect the ACCC's view of another transaction, even where that other transaction may involve the same or a related market.

- As assessments are brief and do not refer to confidential information provided by the parties or other market participants, assessments do not set out all of the issues and information considered by the ACCC, nor all of the analysis and reasons of the ACCC.

The parties

The acquirer: Thales

8. Thales is an international electronics and communications group registered in France and listed on the Euronext Stock Exchange in Paris. Thales provides systems and electronic services globally in five main areas: (i) aeronautics, (ii) space, (iii) ground transportation, (iv) defence, and (v) security. In 2017, Thales had operations in 56 countries with approximately 64,100 employees.
9. In Australia, Thales has operations in every mainland state and territory comprising defence, aerospace, security, transportation and R&D.

The target: Gemalto

10. Gemalto is an international digital security company registered in the Netherlands and listed on the Euronext Stock Exchange in Paris and Amsterdam. Gemalto is involved in the development, manufacture or supply of, and the provision of services relating to, data encryption and security technologies and communications systems. In 2017, Gemalto had operations in 47 countries with approximately 15,000 employees.
11. Gemalto's Australian operations are based in Melbourne and Sydney.

The transaction

12. Thales proposed to acquire all issued and outstanding ordinary shares of Gemalto by way of a full public offer.

Review timeline

13. The following table outlines the timeline of key events for the ACCC in this matter.

Date	Event
24 September 2018	ACCC commenced review under the Merger Process Guidelines.
22 November 2018	Former provisional decision date of 6 December 2018 delayed while ACCC waited for information from parties.
17 December 2018	ACCC received information from the parties.
20 December 2018	ACCC announced it would not oppose the proposed acquisition following the acceptance of a section 87B divestiture undertaking by the ACCC.

14. The total elapsed time from start to finish was just under three months. The total period, net of time taken by the parties to submit information or documents, was 46 business days.

Market inquiries

15. The ACCC conducted market inquiries with a range of industry participants, including competitors, potential competitors, customers, industry bodies, other regulatory agencies and other interested parties. Submissions were sought in relation to the potential competition issues.
16. The ACCC also liaised closely with overseas agencies, including the European Commission, the US Department of Justice and the New Zealand Commerce Commission.

Areas of overlap

17. In Australia, Thales and Gemalto overlap in the supply of:
 - enterprise key management products, including HSMs
 - encryption software for data at rest and in use.
18. The main area of overlap between Thales and Gemalto is in the supply of HSMs, which are enterprise key management products. Enterprise key management products provide encryption keys to access data that has been encrypted and decrypted by an encryption algorithm across a variety of operating systems and databases. The generation, allocation, storage, protection and destruction of keys is critical to the success of data encryption.
19. Thales and Gemalto both supply GP and payment HSMs in Australia. GP HSMs are tamper-resistant hardware devices that run on encryption software and generate keys, encrypt and decrypt data and verify digital signatures. Payment HSMs are similar to GP HSMs, but also have payment-related functionality and perform a high volume of payment operations and payment transaction processing. Payment HSMs are typically used by the retail banking industry.
20. Encryption software performs the encryption and decryption of data to secure and control access to high-value information. Thales and Gemalto did not have a significant presence in Australia for the supply of enterprise encryption software, and there were a number of other significant providers with a global presence that were likely to act as a strong competitive constraint after the acquisition, including Dell, Microsoft, Oracle, Seagate, McAfee, Netscape, Trend Micro and many others. Therefore, the ACCC did not consider that the proposed acquisition was likely to substantially lessen competition in the supply of encryption software.

Competition analysis

21. During the course of its investigation, the ACCC received feedback from market participants, in particular customers of HSMs, that GP HSMs and payment HSMs are not typically substitutable as they serve different purposes and customers would be unlikely to switch from one to the other in response to an

increase in price or reduction in quality. Therefore, the ACCC considered that for the purpose of the competition analysis, separate markets for the supply of GP HSMs and payment HSMs were likely to exist. This approach to market definition was also taken by a number of other competition regulators which considered the proposed acquisition, including the European Commission and the New Zealand Commerce Commission.

22. The ACCC also considered that other solutions such as HSM-as-a-service and cloud-based key management products were not currently a close substitute to traditional on-premise GP and payment HSMs, but could potentially become so in the future. These alternative products were not considered part of the relevant markets.
23. The ACCC considered that the relevant geographic scope of the separate markets for the supply of GP HSM and payment HSM markets was national, noting that competition on product quality predominantly occurs on a global basis as the products supplied in Australia are generally homogenous to those supplied in other countries.

General Purpose HSMs

24. The ACCC considers that Thales and Gemalto are each other's closest competitor and the two largest providers of GP HSMs in Australia and globally. Therefore, the ACCC was concerned that the proposed acquisition could lead to higher prices or reduced service levels for the supply of GP HSMs in Australia. There were also concerns that the removal of Gemalto would have a detrimental impact on innovation.
25. The ACCC received evidence of Thales and Gemalto competing closely with each other across their GP HSM range, including by comparing and contrasting each other's features, functions, performance, technology and reputation to current and potential customers. In some circumstances, customers had leveraged this competition between Thales and Gemalto to obtain better pricing and superior terms.
26. The ACCC considered that barriers to entry for overseas suppliers are likely to be high. Customers of GP HSMs face significant barriers to switching between suppliers as switching is costly, complex, risky and time consuming. Switching involves the migration of cryptographic material and the redevelopment of certain codes and algorithms. The ACCC received information that the process to extract cryptographic material and handle it outside the secure boundary of the GP HSM introduces risks that may deter some customers from switching GP HSM suppliers, and that the time it takes to switch suppliers is generally two to five years and requires a significant amount of testing.
27. Some customers of Thales and Gemalto expressed a strong preference for their GP HSM supplier to have a local presence, as Thales and Gemalto do. Therefore, the ACCC considered that it would take a significant increase in price or decrease in service for customers to switch to a supplier without a local presence.
28. The ACCC concluded that, without the divestiture undertaking, the proposed acquisition was likely to substantially lessen competition for the supply of GP HSMs in Australia.

Payment HSMs

29. Thales and Gemalto supply the vast majority of payment HSMs to Australian customers. Therefore, the ACCC was concerned that the removal of Gemalto could lead to higher prices or lower quality for payment HSMs. However, the ACCC considered that there were a number of factors that made a substantial lessening of competition unlikely for the supply of payment HSMs.
30. Unlike for GP HSMs, Gemalto does not have a significant global presence in the supply of payment HSMs; it previously acquired a company with an already established presence in payment HSMs in Australia.
31. Feedback the ACCC received from industry participants indicated that payment HSMs are generally considered a globally homogenous product, with product development and manufacture occurring in one or two countries from where they are distributed globally. There is a unique Australian standard for payment HSMs (AS2805), but in most cases this standard requires de-activating some functionality rather than any major redesign.
32. In terms of product development and innovation, the ACCC considered that the other global players (including Utimaco, Atos, Ultra Electronics and Futurex), even if they are not present in Australia at the moment, were likely to place a competitive constraint on Thales (both globally and in Australia) in the longer term.
33. The ACCC did not receive evidence of significant switching by customers between Thales and Gemalto in Australia. In the shorter term, the vast majority of sales in Australia are to existing customers via product refreshes or customers expanding their security networks, and these sales are largely uncontested.
34. The ACCC also took into account that the majority of payment HSM sales are to large financial institutions which are likely to have some degree of bargaining power or purchase on a scale sufficient to sponsor a new entrant (for example, for an existing overseas manufacturer to commence supply into Australia). The ACCC also considered that barriers to entry for international suppliers to enter Australia are likely to decline over time.
35. Although the proposed acquisition results in the removal of one of the two major suppliers of payment HSMs in Australia, the factors noted above led the ACCC to conclude that the proposed acquisition was unlikely to substantially lessen competition for the supply of payment HSMs in Australia.

Undertaking

36. In order to remedy the ACCC's competition concerns in respect of GP HSMs, Thales provided a divestiture undertaking to the ACCC to comply with commitments it made to the European Commission to sell its global GP HSM business. The divestiture undertaking requires that Thales obtains ACCC approval of the purchaser of the global GP HSM business, which reflects the global nature of the divestiture obligations and the GP HSM business itself.

37. The ACCC's purchaser approval process will take into account the ability and intention of the proposed purchaser to maintain and operate the business in Australia.
38. The proposed acquisition required review by competition authorities in other jurisdictions and Thales received conditional clearance by the European Commission for the proposed acquisition on 11 December 2018.
39. As a result of the divestiture undertaking and commitments to the European Commission, a new or established global supplier will acquire Thales' nShield HSM brand and assets, including in Australia.

Conclusion

40. Based on the above analysis, the ACCC concluded that the proposed acquisition of Gemalto by Thales, taking into account the divestiture undertaking, would not be likely to have the effect of substantially lessening competition in any market.