

COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 61/LM/Jul06

In the matter between:

SAAB AB

Acquiring Firm

And

**AEROSTRUCTURES BUSINESS
OF DENEL (PTY) LTD**

Target Firm

Panel : N Manoim (Presiding Member), Y Carrim (Tribunal
Member), and U Bhoola (Tribunal Member)
Heard on : 13 September 2006
Decided on : 13 September 2006
Reasons Issued: 19 October 2006

Reasons for Decision (Non-Confidential)

Approval

[1] On 13 September 2006 the Tribunal issued a merger clearance certificate unconditionally approving the merger between SAAB AB and the Aerostructures Business of Denel (Pty) Ltd. The reasons for approving the transaction follow.

The Parties

[2] The primary acquiring firm is Saab AB ("Saab"), a company listed on the Stockholm Stock Exchange. The following are shareholders who have more than 5% shareholding in Saab:

[2.1]	BAE Systems ("BAE")	21%
[2.2]	Investor AB	20%

- [3] The remaining shares in Saab are traded on the Stockholm Stock Exchange.
- [4] BAE has in excess of twenty subsidiaries worldwide and a 20% minority in Airbus, an original equipment manufacturer ("OEM") involved in the first tier market. Apart from BAE's 20% minority shareholding, Airbus is controlled by the governments of Germany and France.
- [5] Investor AB has interests in various companies, which are not important for purposes of this decision.
- [6] Saab has in excess of twenty subsidiaries worldwide.¹ In South Africa it controls Saab Grintek Defence (Pty) Ltd and Saab Grintek Technologies (Pty) Ltd. Earlier this year Saab acquired a South African company called Aerospace Monitoring and Systems (Pty) Ltd.²
- [7] The primary target firm is the Aerostructures Business of Denel ("Aerostructures Business"). Aerostructures Business is a division of Denel (Pty) Ltd ("Denel"). Denel is controlled by the Government of South Africa. The Aerostructures Business does not control any firm, whereas Denel has in excess of ten subsidiaries worldwide.³

The Transaction

- [8] Denel will create a new wholly owned subsidiary ("Newco") and transfer its Aerostructures Business to it. Saab will then acquire 20% of Newco's issued share capital which will give it joint control with Denel.⁴ At the conclusion of the transaction the Aerostructures Business of Denel will be housed in Newco, Saab will have a 20% interest in Newco and Denel will have 80% shareholding in Newco.⁵

The rationale for the transaction

¹ See Annexure B and C of Form CC4(2) filed by the primary acquiring firm.

² The transaction was considered under Competition Commission case number 2006Feb2129.

³ See Annexure A of Form CC 4(2) filed by the primary target firm.

⁴ See page 008 of the record and clause 5.7 of the Memorandum of Understanding on page 474 of the record.

⁵ Post-merger, Saab will render management services to Newco and thereby transfer skills to Newco's employees. Saab will also be required to contribute an agreed portion of the capital needed for the various projects in terms of the agreements concluded with Denel.

- [9] Saab perceives the transaction as creating new business opportunities for it while strengthening its relationship with and its presence in South Africa. Saab also perceives the transaction as increasing its capabilities and strengthening its position in the global aerospace market.
- [10] Denel views the transaction as a first step in its unbundling process as it endeavours to create profitable entities. It intends to un-bundle and refocus on its core business of aerospace, artillery and munitions.⁶ This has been precipitated by the losses that Denel has been making in the past nine years

The parties' activities

The Primary Acquiring Firm

BAE

- [11] In South Africa, BAE trades through BAE System South Africa (Pty) Ltd, which is involved in the manufacturing and supply of armoured vehicle, transmissions, drivelines and related components for land systems. BAE also develops and provides services for naval systems. It also has a minority interest in a company which develops war-gaming, and logistics planning software.⁷
- [12] In the worldwide market, BAE is active in the development, delivery and support of advanced defence aerospace systems. It operates through six business units, namely:
- [12.1] Electronics, Intelligence and Support
- This business unit is responsible for BAE's displays, inertial systems and marine repair activities.
- [12.2] Land and Armaments

⁶ This has been precipitated by the losses that Denel has been making for the past nine years. To survive Denel is pursuing a strategy based on prime contracting locally and exports of defence and aerospace systems and components through selective equity partnerships and alliances with global prime contractors.

⁷ See page 6 of the record.

This unit is involved in the design, development, production and services support of armoured combat vehicles and calibre naval guns.

[12.3] Programmes

This unit comprises BAE's air systems, naval ships and submarines activities.

[12.4] Customer Solutions and Support

This unit includes the integration and delivery of supply chain and logistics management, spares, maintenance, repairs and overhaul.

[12.5] Integrated Systems and Partnership

This unit comprises high-technology defence systems businesses.

[12.6] Commercial Aerospace

The parties have submitted that BAE has since sold its commercial aerostructures business unit to Spirit Aerostructures Inc. There is therefore no need to consider its activities.

Investor AB

[13] In South Africa, Investor AB's only activity relevant for purposes of this transaction is its interest in Saab, the primary acquiring firm.

[14] On a worldwide scale, Investor AB is an investment holding company, which has interests in various sectors including defence. The interest in defence is housed in Saab, the primary acquiring firm in this transaction.

Saab

[15] In South Africa, Saab manufactures and supplies electronics related products and services to the telecommunications, defence, avionics, air traffic management, security and power utilities markets.

- [16] Saab is also active through its recently acquired subsidiary, AMS, which is involved in the development and production of advanced avionics for military and commercial aircraft.⁸

The primary target firm

- [17] The Aerostructures Business comprises the manufacturing and assembly business unit and the airframe structural design section of the development engineering business unit of Denel Aviation. The parties submitted that the primary transferred firm would focus on aerostructure design, development, manufacturing and assembly.

Relevant market

Relevant Geographic market

- [18] The Commission and the parties described the market as international. This is because the merging parties and their competitors are active internationally. The Commission and the parties relied on the European Commission on Competition (“ECC”) case of *British Aerospace and Gen Marconi*⁹ (“*British Aerospace matter*”) where the ECC defined the market as international. For the purposes of this transaction the Tribunal finds no reason to disagree with the Commission’s and the merging parties’ conclusion.

The relevant product market

- [19] The Commission relied on the definition of the market for aerostructures in the ECC case of *British Aerospace* where the aerostructures market was defined as:

“the metal fabrication aspects of aircraft production intended to produce end products such as wings or fuselages. Aerostructures encompass wide range of products from minor components such as

⁸ The parties submitted that ‘avionics’ means aviation electronics. It comprises of all electronic systems designed for use on an aircraft. It is a suite of components and parts making up the control, management and communication systems of an aircraft.

⁹ *British Aerospace and Gen Marconi* European Commission on Competition case number IV/M.1438.

*brackets and cables, through major units such as wings to final aircraft building*¹⁰

- [20] After considering the parties' activities and relying on the ECC's decision in the *British Aerospace* matter, the Commission defined the market as the market for the manufacturing, assembly and supplying of aerostructures. For the purposes of this transaction, the Tribunal does not differ with the proposed market definition.

Competition analysis

Horizontal Relationship

- [21] The Commission submitted that there is a horizontal overlap in the activities of the merging parties as shown below.
- [22] Denel's aerostructures business designs, manufactures, and assembles a variety of aerostructure components and subsystems for an array of customers worldwide.
- [23] Saab supplies complex structural units in metal and composites as well as subsystems to commercial and military aircraft manufacturers. It derives the bulk of its turnover from supplying aerostructures to various aircraft programmes. It also manufactures and assembles almost all aerostructures of Gripen combat aircraft. For Airbus, Saab manufactures an array of aerostructures in terms of various aircraft programmes, which include manufacturing and assembly of mid and outer fixed leading edge of the wing of the A380 superjumbo and ailerons of the airbus A320. With regard to BAE's aerostructure business, as indicated above, BAE has since sold this business unit to Sprit Aerosystems Inc and the Tribunal will, as a result, not consider it.¹¹
- [24] The parties submitted that it is difficult to obtain global market share figures for the supply of aerostructures. They estimated the market share for the Aerostructures Business to be 0.025% and for Saab to be less than 1%

¹⁰ *British Aerospace and Gen Marconi* European Commission on Competition case number IV/M.1438.

¹¹ The parties submitted that although BAE exited the aerostructure market, they will continue to manufacture Hawk until it is completed

globally.¹² The parties will therefore have less than 2% combined market share post-merger in the market for the supply of aerostructures globally.

[25] Post-merger, the merging firms will continue to face competition from players such as Spirit Aerosystems, Vought Aircraft Industries INC, Latecoere, Mitsubishi International Corporation, Societe Anonyme Belge de Constructions Aeronautiques, GKN Aerospace and Stock Aerospace Industries. The parties further submitted that there are approximately 25-30 firms that are active in this tier of the market globally which compete with the merging firms.

[26] In our view, the proposed transaction is unlikely to raise competition concerns, as the parties' post-merger global market share remain low and that there are other players that will continue to compete with the merging firms.

Vertical Relationship

[27] The Commission found that there is a vertical relationship between the merging firms in that in the first instance, Saab and BAE have subcontracted the Aerostructures Business to manufacture and supply them with aerostructures for Gripen aircraft and Hawk military jet respectively. In the second instance, Saab supplied the Aerostructure Business with materials that the Aerostructure Business is utilising to manufacture aerostructures to be supplied to Saab.¹³

[28] The Commission and the parties submitted that the vertical relationship between Saab, BAE and the Aerostructures Business flows from the Defence Industrial Participation (DIP) obligations that the South African government has imposed on them when it awarded contracts for the supply of Gripen aircraft and Hawk military jet to the South African National Defence Force ("SANDF"). DIP is a program in terms of which suppliers of military equipment to the SANDF, are required to "offset" the cost thereof by benefiting the South African economy through investment, technology and skills transfer. As part of fulfilling this obligation, SAAB and BAE channel their supply through Denel or other local suppliers

¹² At the hearing the parties submitted that the source of their estimated market share figures were obtained from Boeing and Airbus, the major players in the aerostructures industry.

¹³ Saab will manufacture and deliver a complete Gripen aircraft and BAE will manufacture and deliver a complete Hawk military jet.

- [29] The commercial aerospace industry consists of five tiers.¹⁴ The first tier involves the market of complete aircraft in which original equipment manufacturers are active. The players active in this market include Airbus and Boeing. Saab and BAE are considered first tier suppliers in respect of the supply of a complete Gripen aircraft and Hawk military jet respectively. The players in the first tier market normally subcontract certain work involving the structures or subsystems of the complete aircraft to tier-two suppliers. Tier-two suppliers supply what is called the “main structure” of the aircraft. Players that are active in tier two include Saab, as a supplier of main structures.
- [30] Tier-two players then subcontract tier-three players such as Aerostructures Business, which will be responsible for assembling structures. The parties submitted that there are approximately twenty-five to thirty firms active in this tier of the market. Tier-three players then subcontract to tier-four to assemble complex parts. The parties submitted that there are about 800 players active in this market. Tier-four then subcontract tier-five suppliers to supply parts and materials.
- [31] In the previous financial year, the Aerostructures Business, a tier-three player, supplied Saab, a tier-one player, with a variety of aerostructures.¹⁵ These aerostructures were supplied to Saab for it to manufacture and deliver complete Gripen Aircraft.¹⁶
- [32] In the previous financial year, the Aerostructures Business also supplied a variety of aerostructures to BAE, one of the major shareholders of Saab.¹⁷ These are aerostructures for Hawk military jet, which Aerostructure Business supplied to BAE for BAE to use them to manufacture a Hawk military Jet.

¹⁴ These tiers exist due to the fact that industry players want to spread the risks associated with non-fulfilment, by subcontracting some activities to other suppliers. These risks include heavy financial penalties for failure to deliver a particular product in time and in accordance with the supply contract awarded to a particular supplier.

¹⁵ These include Gripen Pylon Series, Gripen MLGU Assembly, Gripen Rear Fuselage Assembly, Gripen Design and Development Centre, Gripen Rear Fuselage parts, and Gripen Saab Technology Transfer Plan.

¹⁶ In this regard Saab is a first tier supplier and the Aerostructures Business is a third tier supplier. Saab subcontracted other players which are second tier suppliers to provide main structures of Gripen aircraft. The details of these other players in a second tier are not necessary since they are not part of the current transaction.

¹⁷ Hawk Tailplane RSA, Hawk Tailplane other, Hawk Flap RSA, Hawk Airbrake, Hawk India Tooling, Regional Jet Aileron

- [33] Saab, as a first tier market player, faces competition from players such as Boeing and Airbus while Aerostructures Business, as a third tier market player, faces competition from approximately 30 other players globally.¹⁸
- [34] The Aerostructures Business supplied Saab with aerostructures of Gripen aircraft to the value of approximately R [confidential] million in the preceding financial year. The overall aerostructure market is valued at approximately R [confidential] billion. The R [confidential] million constitutes 0.04% of the entire global aerostructures market. This percentage of the aerostructures supplied to Saab by the Aerostructures Business is insignificant.
- [35] With regard to the vertical relationship between BAE and the Aerostructures Business, the Aerostructures Business supplied BAE with aerostructures to the value of R[confidential] million. This constitutes 0.02% of the entire global aerostructure market. This percentage is also insignificant.
- [36] In addition, the vertical relationship between the Aerostructures Business and SAAB and BAE, as a result of the DIP obligations, is only expected to last until either Saab or BAE has completed and delivered Gripen aircraft or Hawk military jet in terms of their individual supply contract to the South African Defence Force. Of course such a relationship could occur again in the future in the event of them being awarded a further contract by the South African Government. In our view this would not constitute a basis for prohibiting this current transaction. Whether a further contract is awarded to the parties or whether in fact the South African Government will issue another contract for the supply these military aircraft remains to be seen. The competitiveness landscape will have to be assessed at the time that such eventuality occurs.
- [37] On the basis of the information provided to us regarding the relative market shares of the merging parties and the number of players in the relevant markets as discussed above, we are of the view that there is little likelihood of foreclosure.

¹⁸ Record p33.

Public Interest Issues

[38] There are no public interest issues.

Conclusion

[39] The transaction will not lead to a substantial prevention or lessening of competition and is accordingly approved.

Y Carrim

Tribunal Member

19 October 2006

DATE

N Manoim and U Bhoola concur in the judgment of Y Carrim.

Tribunal Researcher: R Kariga

For the merging parties: Lesley Morphet and Leslie de Bruyn, Deneys Reitz
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For the Commission : Edwina Ramohlola and Makgale Motlala (Mergers and
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