OFFICE OF FAIR TRADING

Completed acquisition by Epwin Holdings Limited of Latium Building Products Holdings Limited

ME/5374/12

The OFT's decision on reference under section 22(1) given on 18 June 2012. Full text of decision published 9 August 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. **Epwin Holdings Limited** (Epwin) through its wholly owned subsidiary SBP Limited, services the new build, maintenance and improvement sectors of the private and social housing markets and the commercial building sector through supply to merchants, plastics stockists (including its own stockists), window, door, and conservatory fabricators and installers. It supplies a number of extrusion PVC roofline products and windows, doors, conservatories and sealed units through a number of different brands, including Profile 22, Swish and Sierra.[1] Epwin achieved a turnover of £[ ] million for the 2011 financial year.

2. **Latium Building Products Holdings Limited** [i] (Latium) supplied PVC extruded building products through its brands Spectus, Kestrel-BCE, Celuform and also had a glass processing business - CET. In the year to 31 December 2011, Latium's UK turnover was £[ ] million.

[1] Other Epwin Brands include: Amazon Civils, DB Glass, Dekura, Europlas, Foilex, Indigo, KB Plastics, Patio Master, Permadoor, Plaslyne, Plastal,Quay Plastics, Safe Doors, Safe Ware, The Window Store, Window Build and Wrekin Windows.

TRANSACTION

3. Epwin acquired Latium through a 'share for share' exchange with no cash consideration on 16 January 2012. The merger parties chose not to notify the merger to the OFT. The OFT examined this merger following an unsolicited complaint. Epwin provided Initial Undertakings pursuant to section 71 of the Enterprise Act 2002 (the Act) in respect of the cellular businesses of Swish BP (Epwin) and Kestrel-BCE (Latium) on 27 February 2012. The extended administrative deadline for a decision is 6 June 2012, and the statutory deadline, as extended by Section 25(2), is 18 June 2012.

JURISDICTION

4. As a result of this transaction Epwin's and Latium's UK operations have ceased to be distinct. The parties overlap in the manufacture and supply of PVC roofline products, with a combined share in the UK of more than 25 per cent. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is therefore met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

COUNTERFACTUAL

5. The OFT assesses the competitive effects of a merger by comparing the prospects for competition with the merger against the competitive situation absent the merger.[2] In practice, the OFT generally adopts the prevailing conditions of competition as the counterfactual against which to assess the merger. The OFT will consider an alternative where, based on the evidence available, it considers that the prospect of prevailing conditions continuing is not realistic. On the evidence available in this case, the OFT considers the pre-merger competitive situation to be the appropriate counterfactual.

MARKET DEFINITION

6. The parties overlap in the production and supply of several products including window profiles, window frames, glass sealed units, rainwater components, and roofline products extruded from PVC such as soffit boards, fascia and cladding. Epwin also operates its own chain of stockists supplying PVC-based

[2] *Merger Assessment Guidelines*, section 4.3.

products to builders, roofers and installers. Latium did not operate such stockists.

7. The parties' estimated combined shares of supply of window profiles, window frames, and glass sealed units do not exceed [10-20] per cent with increments of less than [0-10] per cent. The OFT received no third party concerns in relation to the supply of these products. As such the supply of these products is not considered further.

Product scope

8. The OFT's approach to product market definition is generally to firstly consider whether narrow candidate markets can be widened through substitution on the demand-side. If appropriate, the OFT then considers if substitution on the supply-side allows several products, which are not demand-side substitutes, to be aggregated into one wider market. [3]

9. On the demand-side, the OFT uses the 'hypothetical monopolist test' to assess whether substitute products should be included in the relevant product frame. [4] On the supply-side, the evidence that the OFT may consider in deciding whether to aggregate markets includes evidence that most suppliers supply many of the products and that they have the ability and incentive to quickly shift production capacity between products in response to variations in price differentials over time.[5]

PVC Roofline products

10. The industry uses the term 'roofline product' to cover a number of different products used in building or repairing the area around the roof of a house. These will include products such as soffit boards and fascia boards, cladding on the sides of houses, and products for the collection of rainwater.

Demand-side substitution

11. On the demand-side the narrowest candidate markets are separate markets for individual products such as a soffit board or a fascia board (and even

[3] OFT/CC *Merger Assessment Guidelines*, September 2010 (OFT1254), paragraphs 5.2.6 to 5.2.19.

[4] *Merger Assessment Guidelines*, paragraph 5.2.10.

[5] *Merger Assessment Guidelines*, paragraph 5.2.17.

varying widths of board such as 10mm compared to 18mm soffit board) with some third parties saying, that each product has a specific use and that customers would not switch between the products following a price rise in one of the products.

12. Epwin submitted that on the demand-side there are various non-PVC products that are substitutes for the PVC products described above, for example timber fascia and metal guttering, and as such these alternative products should be included within any market definition. Epwin considered that timber is a fundamental part of the roofline market and its availability as a significantly cheaper alternative to PVC acts as a clear constraint on PVC suppliers.

13. While the OFT notes that, for example, timber can be used in the place of certain PVC products, third parties generally stated that they would not switch from PVC following a five per cent price rise in PVC roofline products, including rainwater goods.

14. Stockists purchase product from manufacturers and sell to end users through their stores. They stated that they specialise in PVC products and do not purchase products such as timber fascia. Therefore, stockists do not generally consider timber fascia as a substitute for PVC products. Large house builders stated that they only use non-PVC products where planning permission or specification dictates but otherwise purchase PVC as it is maintenance free. Based on this evidence and taking a cautious approach the OFT is not minded to consider non-PVC products in the same market as PVC products.

Supply-side substitution

15. On the supply-side the majority of PVC roofline products are produced through a high volume manufacturing process in which raw PVC is melted and extruded into a continuous profile which is then cut to required lengths. The parties submitted that the process is very similar for most products with different tool heads used to extrude different types of products such as soffits and fascia.

16. Epwin submitted evidence[6] showing the ease of switching production between the different types of PVC roofline products. Third party

[6] Including a video of the changing of the tool head or dye, taking approximately four hours.

competitors, who all stated that they produced the full range of PVC roofline products (excluding rainwater products), confirmed that they can easily switch production from one product to another using the same machinery. As PVC window trims are produced using the same process as PVC roofline products and the same firms compete to supply these different products Epwin submitted, and third parties agreed, that extruded PVC window trims should be included in the market for PVC roofline products, excluding rainwater, on the basis of supply-side substitution.

17. In addition, the parties submitted, and third parties confirmed, that the same firms compete to supply these different roofline products (excluding rainwater products) and the conditions of competition between the firms are the same for each product.[7] The OFT notes that the key UK competitors appear to supply the full range of roofline products to either independent stockists or direct to customers such as national house building firms, with negotiations relating to the full range rather than for individual products.

Distinction between PVC roofline and rainwater products

18. Epwin submitted, with regard to PVC rainwater products, that these products should be included in the product scope, as they are sold and installed together and can be produced using substantially the same extrusion technology and production machinery. The OFT considered whether to aggregate PVC roofline products with PVC rainwater products on the supply-side. However, the OFT notes that PVC rainwater products are different in nature being rigid rather than cellular. In order to supply PVC rainwater products, manufacturers must also produce a number of unique small connector products. This combination of product characteristics and multiple connector products leads to a distinction between the manufacture of soffits, fascia, cladding and window trims, on the one hand, and rainwater products on the other. The latter are, according to the available evidence, more time consuming to produce.[ii] In addition, while, to some extent, the same firms [8] compete to supply PVC rainwater products as PVC roofline products, the conditions of competition and shares of supply are markedly different between the two groups of products. In addition, Epwin submitted that while stockists purchase other PVC roofline products from a number of

[7] *Merger Assessment Guidelines*, paragraph 5.2.17.

[8] However, Epwin also identified very large specialist extruders Polypipe and Wavin as competitors in rainwater products. Neither company are active in other PVC roofline products.

manufacturers this is not the case for PVC rainwater products where 'system connectivity' means that for practical reasons only one supplier is used. Third parties also stated that, to a greater extent, PVC rainwater products are sold through builders' merchants and DIY stores in comparison to other PVC roofline products which are primarily sold through specialist stockists.

Segmentation by distribution channel

19. The OFT has also considered whether it is appropriate to adopt separate frames of reference for different channels of distribution. This is because the OFT's investigation has indicated that there tends to be a distinction in the way in which products are supplied to independent stockists and those supplied through directly negotiated contracts to roofers and builders (see paragraph 36 below). As noted below, the OFT has not found it necessary to conclude on market definition but has considered in its competitive assessment whether harm will arise on either of these candidate narrow market segments.

20. The OFT has not found it necessary to conclude on product market definition. However, on the basis of the available evidence, the OFT has examined this merger on the basis of the candidate markets for the manufacture and supply of PVC roofline products (excluding rainwater products, but including fascia, soffits, and cladding) and PVC window trims together and, separately, the manufacture and supply of PVC rainwater products (including guttering, pipes and connecting joints). Within the overall supply of PVC roofline products, the OFT has also considered two segments: supply to independent stockists and supply through directly negotiated contracts to house builders and roofing contractors.

Geographic scope

21. Epwin submitted that the relevant geographic market for both PVC roofline products and PVC rainwater products is the UK and the Republic of Ireland (ROI) on the basis that the products supplied in the UK and ROI are broadly similar and that the same firms compete in both countries.

22. Epwin also noted that the merging parties supply outside of UK and ROI, however it stated that there are certain production requirements in countries such as France which limit the scope for exporting from the UK or ROI. Nevertheless, it said that France is both a major market for UK exports and a

major European producer of cellular PVC product with several manufacturers.[9] Additionally, it submitted, most of the merged entities' competitors export to France and while continental producers typically only produce around 30 per cent of the product range offered by UK manufacturers[10] they are actively seeking business in the UK. Epwin submitted that Plastivan, a Belgian manufacturer, operates in the UK from a warehouse in Bristol, and supplies a number of UK stockists.

23. The OFT notes that two of the largest suppliers in the UK of both PVC roofline products and PVC rainwater products operate production facilities in the ROI as well as the UK. The evidence indicates that the decrease in house building in ROI from 2008 due to the economic crisis led to an increase in imports of roofline products into the UK from ROI based suppliers.

24. The industry report by D&G Consulting[11] treats the UK and ROI as being part of the same geographic market based on the high proportion of exports between the two countries. The report estimates that all of the 3,400 tonnes of extruded cellular foam (not including twin wall hollow roofline products) PVC roofline products imports to the ROI came from the UK and over 90 per cent of the 10,400 tonnes of imports of extruded cellular foam to the UK came from the ROI, approximately 15.7 per cent of total UK production.

25. When questioned by the OFT, third party customers stated that they did not consider there were credible firms from outside of the UK and the ROI. Although some third party customers referred to Belgian and German suppliers as possible suppliers, overall they considered that these suppliers do not have the product portfolio or depth necessary to supply in volume to the UK.

26. The OFT has not seen any evidence that suggests that the geographic market is narrower than all of the UK since all manufacturers supply across the UK. Customers did not consider that regional manufacturing facilities were important. Those customers who negotiated directly with manufacturers stated that they did not require a local presence from the manufacturer as they purchased through stockists and it was the stockist who competed at the regional and local level.

[9] For example, Omniplas, Nicoll, and Espace Clair.

[10] Epwin submits that Omniplast, Zumaplast, Vox and Nicoll now all have thick boards and are therefore able to cover all roofline requirements.

[11] The PVC Roofline Products Industry in the UK &Republic of Ireland, Market & Forecasts to 2014 2011 Edition - D&G Consulting

27. Based on the evidence above the OFT has analysed the merger for both PVC roofline products and PVC rainwater products on the basis of the UK and ROI together. However, the OFT also notes that if it were to assess the merger on the basis of the UK only it would not make any material change to its competition assessment. The OFT has not found it necessary to conclude on the geographic market in this case.

THEORIES OF HARM

28. Following the OFT's market investigation it identified three theories of harm arising from the merger namely:

- unilateral effects, resulting in price rises for directly negotiated contracts with roofers and builders due to a reduction in the number of competitors able to service these contracts

- unilateral effects impacting on the supply of PVC roofline products to independent stockists, resulting in increased prices, and

- vertical effects, resulting in potential price increases to downstream rivals (that is, other stockists).

29. Unilateral effects can arise in a horizontal merger when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm to profitably raise prices on its own and without needing to coordinate with its rivals. [12]

Rainwater products

30. The OFT also considered the impact of the transaction on the supply of PVC rainwater products. Epwin estimated that the merged entities' combined market share for the manufacture and supply of PVC rainwater products was [ ] per cent in 2011 (increment [ ] per cent) which is at a level that does not generally raise prima facie competition concerns.[13] Epwin's estimate is based

[12] *Merger Assessment Guidelines*, paragraph 5.4.1
[13] *Merger Assessment Guidelines*, paragraph 5.3.5

on the D&G Consulting[14] forecasts for 2011 PVC rainwater products production in the UK and the merged entities' own production in 2011.[iii]

31. In addition, third parties noted that the merged parties were not particularly close competitors in the supply of PVC rainwater products. Floplast was named as the largest producer of PVC rainwater products with a market share of around 30-40 per cent. Third parties also identified Polypipe and Wavin as suppliers of PVC rainwater products. No competition concerns arising from the merger in relation to the manufacture and supply of PVC rainwater products were raised by third parties.

32. Therefore on the basis of the evidence above, the OFT does not consider there to be a realistic prospect of a substantial lessening of competition (SLC) from the merger in the manufacture and supply of PVC rainwater products, and this product market is not considered further.

Supply of roofline products to all supply channels

Shares of supply

33. Epwin estimated that the merged entities' combined share of supply of the manufacture and supply of PVC roofline products in 2011 was [35 - 45] per cent (increment [15-25] per cent).[15] These estimates did not include twin wall hollow soffits. The OFT's estimates [16] of the merged entity's combined shares of supply in the production of PVC roofline products including twin wall hollow soffits in the UK and ROI are [40-50] per cent (increment [15 -25] per cent).

34. In response to the OFT's Issues Paper Epwin raised concerns over the accuracy of the estimates in the D&G Consulting report, believing them to be overstated due to anomalies in data collection, errors in the data and the

[14] D&G Consulting Report 2011 Edition: The PVC Roofline Industry in the UK & Republic of Ireland. Market & Forecasts to 2014.

[15] Epwin's used its knowledge of its own production in 2011 and D&G Consulting forecasts for 2011 PVC roofline products production in the UK to produce the estimate of the merged entities combined share of supply for 2011.

[16] The OFT used Table 2 and Table 22 of the D&G Consulting Report - 2011 Edition: The PVC Roofline Industry in the UK & Republic of Ireland. Market & Forecasts to 2014, to estimate 2009 and 2010 shares of supply for the merged entity and its main competitors for the production of PVC roofline products including twin wall hollow soffits in the UK and ROI.

omission of imports; and consequently provided revised estimated market shares for production in the UK and ROI for 2010 set out below in Table 1.

Table 1 – Merged entities estimates for 2010 UK and ROI production of PVC roofline products

	Tonnage	per cent
Epwin	[ ]	[15-25]
Latium	[ ]	[10-20]
Combined	**[ ]**	**[35-45]**
Eurocell & Deeplas business of Deceunik[17]	[ ]	[20-30]
Freefoam	[ ]	[10-20]
Floplast	[ ]	[0-10]
Homeline /Gap	[ ]	[5-15]
Kalsi	[ ]	[0-10]
Anglian	[ ]	[0-10]
LB Plastics	[ ]	[0-10]
MFP	[ ]	[0-10]
Others	[ ]	[0-10]
Total market	[ ]	100

Source: Epwin's estimates

35. The OFT notes that Epwin's revised estimate is only based on cellular foam PVC roofline products and does not include [ ] tonnes of twin wall hollow soffits. In addition, Latium's figures have been adjusted to remove certain production[18] that the merged entity states is business that is [ ].

36. The OFT was unable to verify the production tonnage of all third party competitors and therefore the merged entities' market shares are best regarded as being in a range between 35 and 45 per cent, increment 15 - 25 per cent; which the OFT notes is consistent with the parties' estimate. In addition, those third parties that responded to the OFT's market testing considered that the parties, after the merger, would be the largest supplier of PVC roofline products. The OFT considers that the parties' combined shares of supply is indicative of a relatively strong position in the manufacture and supply of PVC roofline products overall. However, in light of the concerns received by the OFT, the OFT has not concluded whether a realistic prospect of a substantial lessening of competition arises in the overall supply of PVC

[17] Eurocell acquired the Deeplas Brand from Deceuninck in 2009.
[18] Namely Latium's [ ].

roofline products and has assessed whether concerns arise in the supply of such products to independent stockists and through directly negotiated contracts to house builders and roofing contractors.

Unilateral effects in different distribution channels

37. As noted above, in paragraph 28, the OFT has assessed whether unilateral effects arise in relation to two distribution channels and whether vertical effects arise. This is because third parties submitted that there were three main ways in which manufacturers compete to supply PVC roofline products:

- competition for the supply of products to builders or roofers through direct price and specification negotiations where supply can then either be through the manufacturers' own stockists or other stockists at agreed prices

- competition for the supply of products to stockists who then set prices to builders or roofers and

- competition for the supply of products to builders or roofers through their own stockists for vertically integrated manufacturers (this supply route is discussed below under vertical effects).

Direct negotiations with roofers and builders

38. As discussed above, manufacturers not only supply stockists and general builders merchants who then sell the products to roofers and builders, they will also enter into direct negotiations with roofers and builders based on price, volume, specification, and availability of product. These roofers and builders then purchase the product either through manufacturer owned stockists or independent stockists. Where purchases are made through an independent stockist the price to the end user is set by the manufacturer and the stockist and manufacturer will agree a margin for these sales. In addition, stockists may enter in to negotiations with roofers and builders for large supply contracts jointly with manufacturers. In these cases the manufacturer agrees to support the price to the roofer or builder by lowering their price to the stockist for the product supplied for that contract.

39. Epwin argued that there is no differentiation between manufacturer owned and independent stockists since all manufacturers will, to a greater or lesser degree supply their product to independent stockists. However, with regard to directly negotiated price and specifications, third party comment received by the OFT indicated that not all builders or roofers are able to directly negotiate with manufacturers since they do not purchase large enough quantities of PVC roofline products. Indeed, Epwin submitted that 'whilst large users buy direct from manufacturers, most users are supplied via specialist plastic stockists'. Further to this the merged entity estimated that only [10-20] per cent of its own supply of PVC roofline products was through directly negotiated specifications with builders or roofers.

40. Third party stockists submitted that the parties were each other's closest competitor for supply to roofers and builders through directly negotiated contracts. The OFT's investigation suggested that the merger parties were by far the largest players in this sector, with indications from third parties that shares may be in the region of [55-65] per cent and could be up to [ ] per cent.

41. Third parties also submitted that the number of potential competitors for these larger contracts was limited by the scale of production of the firms and the resources available to them for negotiating direct sales. In this regard the merger parties were considered to be each other's closest competitors, with third parties generally naming the other party when asked who they would consider switching to. Some third parties also commented that following the merger there would be no other viable alternative for PVC roofline products.

42. Taking this into account the prevailing view of third parties was that, at best, there were only five potential competitors capable of direct negotiations with roofers and builders, namely; the parties, Freefoam, Eurocell, and Homeline. [ ]. On this evidence, the merger may be likely to reduce the effective choice of suppliers for large contracts from four to three suppliers.

43. The parties submitted records of bids where they had either entered in to discussion with stockists to support large contracts to roofers and builders, or have had direct price negotiations with roofers and builders. This evidence supported the fact that the parties were close competitors who faced some competition from Eurocell and Freefoam. However, the data submitted was incomplete and the OFT has not been able to sufficiently assess the level of constraint the merged entity would face from other firms in this market

segment. In addition, this evidence does corroborate third party submissions that the parties compete closely for large contracts directly negotiated with roofers and builders.

44. Stockists[19] highlighted directly negotiated contracts for new build houses in particular as a segment where it was considered that the parties competed closely. Epwin submitted estimates of the merged entity's combined market share for new build houses at [34-40] per cent (increment [five-15] per cent). However the OFT notes that this estimate is based on the percentage of all completed new build houses, rather than those houses where the PVC roofline products were supplied via directly negotiated contracts with a manufacturer and, as such, this is likely to be an underestimate of the merged entity's market shares for this customer segment.

45. House builders themselves were generally of the view that the parties were close competitors, with a number stating that the parties were the only two viable suppliers for large scale national contracts across a variety of sites.

46. While the OFT recognises that Eurocell and Freefoam also compete for these contracts, it notes that [ ] is smaller than either of the merger parties ([ ]).[20] Stockists considered that the merger parties were each other's closest competitor and that the number of potential competitors for these larger contracts was limited by the scale of production of the firms. Third party stockists also submitted that the merger parties together supplied over [55-65] per cent of customers with directly negotiated contracts. The OFT therefore considers that the above evidence indicates that the merger gives rise to a realistic prospect of a SLC in the supply of PVC roofline products directly to roofers and builders for large contracts.

Supply to independent specialist stockists

47. The merged entities both supply PVC roofline products to independent stockists who then sell these products to roofers or builders. One Stockist stated that it has supply contracts with manufacturers such as the merged entity[iv] where prices are negotiated based on the volume of sales for a range of PVC roofline products. Stockists stated that in many cases they will multi

[19] Stockists will, in some cases, supply the products for the contract that a customer has directly negotiated with the manufacturer.
[20] [ ].

source to ensure ready availability of product and competitive pricing. Stockists range from large chains with national or regional coverage to small firms selling from single sites. Information available to the OFT show that there are around 4,000-5,000 outlets [21] stocking PVC roofline products in the UK, of which around 600-900 are independent specialist stockists. Manufacturer owned stockists amount to at least 174 outlets.[22]

48. Based on data[v] in the D&G Consulting report the OFT calculated 2010 market shares for the supply to stockists excluding those manufacturers that operate their own integrated stockist networks [23] and allocating [10-20] per cent of the Epwin production to supply through their own stockists. These estimates gave the merged entity a share of supply to independent stockists of some [55-65] per cent, increment [25-35] per cent.[24] The two alternative suppliers highlighted by stockists, Freefoam and Floplast, would therefore have an estimated [15-25] per cent and [five-15] per cent market shares respectively. The OFT appreciates that these estimates may overstate to some extent the merged entities' share since they do not take account of product supplied by Eurocell, Homeline (Gap) and Kalsi to independents, but nevertheless the information available to the OFT indicates that the parties are the two leading suppliers of PVC roofline products to independent stockists.

Closeness of competition

49. Epwin has submitted that Latium was not a close competitor in the supply of roofline products to independent stockists. It considered Eurocell and Freefoam to be its closest and strongest competitors prior to the merger. It argued that Eurocell, Freefoam and other competitors competed aggressively with Epwin and Latium for sales of cellular roofline products to independent stockists, builder's merchants, house builders and other distributors.

[21] Which includes general builders merchants, and DIY outlets, as well as the independent stockist and manufacturer owned stockists.

[22] Eurocell – over 120 stockists - www.eurocell.co.uk/8/branch-finder, Gap 27 stockists - http://gap.uk.com/depot-network, and Epwin 26 stockists.

[23] The manufacturers who operate their own integrated stockist networks are Eurocell (but not Deeplas), and Homeline (GAP). Kalsi's web site: www.kalsiplastics.co.uk notes that it supplies a network of approved stockists, however it is not clear whether these are manufacturer owned. Anglian supplies to end consumers via its own business.

[24] It should be noted that this is for all supply of PVC roofline products and as such includes supply to stockists where the manufacturer negotiates directly with the end consumer on price and specification and then the stockist agrees a margin with the manufacturer for selling the product through them.

50. However, all stockists who responded to the OFT's investigation considered that the parties were close competitors. Third parties stated that Eurocell, Homeline (GAP), Kalsi, and Anglian primarily supply their own stockist networks and would not be considered an alternative to the parties. That being the case, stockists stated that the only alternatives to the parties were Freefoam and Floplast. [25] Third parties estimated the parties' share of supply to stockists to be in excess of 60 per cent. The OFT notes that these estimates are similar to those set out in the D&G Consulting report.

51. The OFT has assessed the extent to which a manufacturer which operates its own chain of stockists will supply PVC roofline and other products to independent stockists. Epwin provided anecdotal evidence of manufacturers with integrated stockists supplying their product to independent stockists and general builder's merchants. The OFT was able to confirm that this was the case. However, it appeared, in respect of [ ] at least, that there were restrictions on supply to stockists in areas which overlap with their integrated stockists. Therefore, the OFT is concerned, on the basis of the available evidence, that a number of independent stockists would face substantially reduced choice of supplier after the merger.

52. All third parties' commented that Epwin is also vertically integrated with 26 of its own stockist outlets and that third party stockists would consequently take this into account when purchasing their products. Set against this, however, third party stockists stated that compared to other vertically integrated suppliers Epwin has a far greater propensity to supply independent stockists due to its relatively small number of stockist outlets. This is confirmed by the merged entities' estimates that Epwin only sells [10-20] per cent of its PVC roofline products through its own stockists. Therefore, independent stockists can generally rely on Epwin for supply.

Switching costs for stockists

53. Epwin submitted that there are low switching costs for stockists and that the products supplied are commodity products which are homogeneous across manufacturers. In its view, should the merged entity attempt to raise prices to stockists, they would switch to other suppliers such as Freefoam and

[25] While Deceunik also supply products in this market they do not supply the full range but instead focus primarily on window products including window trims.

Floplast. Therefore, the presence of two other key suppliers after the merger may be enough to protect stockists in an environment of low switching costs.[26] Stockists confirmed that switching from one supplier to another is relatively easy and as such they already do this through multi-sourcing PVC roofline products. However, stockists stated that there are additional costs in establishing a new supplier, such as ensuring product compatibility, phasing out previous stock, and changing of marketing and catalogue materials, although these costs were not considered prohibitive. The OFT is also conscious that the merger combined with the restrictions on the number of suppliers due to the possible supply restrictions due to manufacturers own integrated stockist networks, the OFT considers, on the basis of the available evidence, that switching costs are likely to vary for independent stockists dependent on their size, geographic location and supply requirements. As such, the OFT has not been able to conclude that switching costs are so low as to outweigh the competition concerns identified.

Restrictions on spare capacity

54. Moreover, and irrespective of the ease of switching, stockists generally stated that they did not believe Freefoam and Floplast had sufficient spare capacity to be able to supply the PVC roofline products currently purchased from either of the merged parties, and that the merger therefore restricted stockists' choice of supplier to the merged entity.

55. Epwin submitted that there is considerable spare capacity in the production of PVC roofline products. The D&G Consulting report estimates that current utilisation of production assets across the industry is 40 per cent. This is based on an estimate of the number of extrusion lines operated by each supplier and assumptions on the output potential of these lines. D&G's estimates of capacity shares for all distribution channels for PVC roofline products are set out in table 2. These shares are also based on the estimated number of extrusion lines operated by each firm (it should however be noted that these estimates are for all extrusion lines not just those currently used to produce PVC roofline products).

[26] OFT guidance notes that unilateral effects are more likely where customers have little choice of alternative supplier, for example because of the level of switching costs (*Merger Assessment Guidelines*, paragraph 5.4.5).

Table 2 - Capacity for the production of PVC roofline products

	Tonnes	Number of Lines	Per cent of total Lines
Epwin (Swish)	17000	29	22
Latium	14250	37	28
Combined	**31250**	**66**	**51**
Eurocell & Deeplas business of Deceunik[27]	16250	22	17
Freefoam	10250	13	10
Floplast (Cork)	4500	5	4
Homeline (GAP)	4000	13	10
Kalsi	1500	4	3
Anglian	1100	3	2
LB Plastics	600	2	2
MFP	500	2	2
Total	69950	130	100

Source: Table 17. D&G Consulting Report 2011 Edition: The PVC Roofline Industry in the UK and Republic of Ireland. Market & Forecasts to 2014.

56. However, Epwin submitted, and third party competitors confirmed, that measuring capacity cannot be purely based on the number of extrusion lines. With regard to the merged entity, Epwin has submitted that the capacity estimates in the D&G Consulting report are incorrect largely due to the incorrect number of machines and a lack of appreciation of the quality of Latium's production lines and the impact this has on its output capacity.

57. The OFT investigated the level of capacity (and current spare capacity) directly with the parties and third parties. Epwin submitted that they are operating [15-25] extrusion lines, [five-15] of which are currently producing PVC roofline products (with differing levels of productivity depending on the age of the equipment). Further to this Epwin estimated that they have [20-30] per cent spare capacity in the production of PVC roofline product. Latium stated that they are operating [30-40] extrusion lines, [15-25] of which are currently producing PVC roofline products. Latium estimated that overall they have [25-35] per cent spare capacity ranging from some lines operating with

[27] Eurocell acquired the Deeplas Brand from Deceuninck in 2009.

no spare capacity to lines operating with over [65-75] per cent spare capacity.

58. As for competitors, [ ]. [ ]. Nevertheless, the OFT notes that on the information available to it, [ ]. [ ].

59. Therefore, overall, there is sufficient doubt as to the level of spare capacity in the industry, that would enable the merger parties' competitors to meet demand to replace supplies from the merged entity from either the independent stockists or for directly negotiated contracts. The OFT therefore believes that this, combined with data on the share of supply to independent stockists and third party comments, indicates that the merger gives rise to a realistic prospect of a substantial lessening of competition in the supply of PVC roofline products to independent stockists.

Possible price effects of the merger

60. Given the above findings on the merger's affect on the supply of PVC roofline products, whether to roofers and builders directly or to independent stockists, the OFT is concerned that after the merger prices will increase.

61. Epwin submitted that it was extremely difficult to increase prices to recover raw material price increases, even when all competitors are impacted by the same increases. It submitted that PVC resin had increased by [40-50] per cent between January 2009 and December 2011, while Epwin had only been able to increase prices by [ ] per cent per tonne in the same period. However, Epwin also provided evidence that its gross margins, at around [ ] per cent, with operating profits of around [ ] per cent for the same period, had largely been level over the period which would suggest that it had been able to pass through raw material price increases. Indeed, information submitted by the parties shows that for both firms gross profits have [ ] per cent since 2007 despite the overall major downturn in the construction sector. The OFT considers these profit margins to be [ ].[28] Indeed, given the parties high shares in the supply to independent stockists and in direct negotiations with roofers and builders for large contracts (both of over [ ] per cent) it can be inferred

[28] Moreover, OFT guidance says that 'if the variable profit margins of the products of the merger firms are high, unilateral effects are more likely because the value of sales recaptured by the merged firm will be greater, making the price rise less costly', *Merger Assessment Guidelines*, paragraph 5.4.9

that the diversion ratio from one merger party to the other is likely to be high within these distribution channels. Combining [ ] profits with a high diversion ratio is likely to lead to meaningful upward pricing pressure after the merger.

62. As an alternative approach, the OFT used the parties' margins and their shares of supply to undertake an assessment of the pressure for price effects arising from the merger irrespective of the products' route to market (and treating the relevant products as undifferentiated). In doing this, the OFT took account of whether there may be excess capacity in the industry or whether competitors are capacity constrained.[29] Assuming linear demand, the OFT has estimated that in the event that there is significant spare capacity, the effect of the merger would be to raise prices by [ ] per cent. However, if competitors are all capacity constrained (a very cautious assumption), such that they cannot expand production in response to a price rise by the parties, the estimated effect on price of the merger would be around [ ] per cent. Similar calculations based on different demand functions are also indicative of upward pressure on prices.

63. The OFT notes that this basic merger simulation has significant caveats and applies a number of restrictive assumptions and limitations. The results must therefore be considered alongside all of the other evidence received and analysis carried out during the OFT's investigation. However, taken in the round they are consistent with unilateral effects concerns in this case.

VERTICAL EFFECTS

64. Epwin operates 26 stockists and is vertically integrated from manufacture to supply, while Latium does not own any stockists. As a result the merger has a non-horizontal element. The OFT therefore considered the merged entity's ability and incentive to engage in input foreclosure strategy through raising prices or other diminishing other services to downstream rivals (that is, other stockists) in order to benefit its own downstream integrated stockists.[30]

65. As referred to above the OFT calculated 2010 market shares for the supply to stockists excluding Eurocell, Homeline (GAP), Kalsi, and Anglian, based on data[vi] in the D&G Consulting report. These estimates gave the merged entity a

[29] The OFT used the same model as was employed in Anticipated acquisition by Kingspan Group plc of CRH Insulation Europe, a division of CRH plc, ME/4807/10, 21 March 2011.
[30] *Merger Assessment Guidelines*, paragraph 5.6.6

share of supply of roofline products to independent stockists of around [55-65] per cent, increment [25-35] per cent.[31] The OFT considers that this may indicate that the merged entity has the ability to raise prices or diminish service offering to independent stockists. The OFT has therefore considered whether it would have the incentive to do so.

66. With regards to incentive the OFT notes, by way of background, that pre-merger Epwin was vertically integrated but only operated 26 stockists and that [80-90] per cent of Epwin's PVC roofline products were supplied to independent stockists. In addition, there are at least two manufacturers who are also vertically integrated (including Eurocell[32] with an approximate [20-30] market share of PVC roofline products[33] and 121 stockists). These manufacturers therefore compete with independent stockists and Epwin's own stockists to supply roofers and builders and do not purchase supplies from Epwin.

67. On the basis of the available evidence, the OFT considers that the merged entity has a limited incentive to raise prices to independent stockists. This is, in part, due to a combination of the small size of Epwin's integrated stockists (compared with other manufacturers) and the importance, therefore, to Epwin of sales through the independent stockists. Specifically, Epwin only has a small number of vertically integrated stockists in which to recoup these lost sales (less than [10-20] per cent of the total number of vertically integrated stockists) it is likely not to be able to recoup a sufficient amount to make such a strategy profitable. Therefore the OFT does not believe that there is a realistic prospect of an SLC arising from vertical effects.

Barriers to entry and expansion

68. The OFT will take into consideration the response of others to the merger, for example entry by new firms, or the merged firm's rivals taking actions enhancing their ability to compete against the merged firm such as expanding production capacity.[34] In assessing whether entry or expansion might prevent

[31] It should be noted that this is for all supply of PVC roofline products and as such includes supply to stockists where the manufacturer negotiates directly with the end consumer on price and specification and then the stockist agrees a margin with the manufacturer for selling the product through them.

[32] Excluding its Deeplas brand, which is sold through independent stockists.

[33] See Table 1- Merged entities estimates.

[34] *Merger Assessment Guidelines*, paragraph 5.8.1

an SLC, the OFT considers whether such entry or expansion would be timely; likely; and sufficient.[35]

69. Epwin submitted that there are low barriers to entry to the supply of PVC roofline products for firms currently operating extruding machinery such as those manufacturing window profiles. In addition Epwin state that expansion by current manufacturers of PVC roofline products would not be costly, estimating that tooling for new products could cost between £ [ ] to £ [ ] per product. The D&G Consulting report estimates the highest output extrusion lines cost £600,000. However the OFT notes that third parties submitted and the D&G Consulting reports confirms that there has been no entry in to the PVC roofline products market in the last five years and that in fact several firms have exited or been acquired by other manufacturers.

70. With respect to de novo entry third parties stated that 'to enter the market on any sort of competitive scale is virtually impossible' and pointed to large economies of scale [36] based on efficient operation of extrusion lines as a barrier to entry. Third parties estimated that it would cost over £2 million to enter the market with sufficient manufacturing capacity and infrastructure to compete effectively (one detailed estimate was for £12.5m for 10 extrusion lines). The likelihood of this entry was also questioned by third parties who stated the time period to earn a profit would be in excess of five years and that it 'would be hard to generate enough sales as you would be trying to take business from established players'.

71. With respect to expansion by existing manufacturers the OFT notes that [ ] and as such expansion would need to be of a sufficient scale to counter any potential SLC.[37] For example to increase production to a similar scale to either of the merging parties would require at least a £2 million investment in new lines. [ ]. Further to this the OFT notes that according to the D&G Consulting report the number of extrusion lines has fallen from 155 in 2005 to 130 in 2010.[38]

72. Epwin has pointed to potential expansion into the UK from continental suppliers, including Omniplas, Nicoll, and Espace Clair and actual expansion

[35] *Merger Assessment Guidelines*, paragraph 5.8.3

[36] *Merger Assessment Guidelines*, paragraph 5.8.5

[37] *Merger Assessment Guidelines*, paragraph 5.8.10.

[38] Table 16. D&G Consulting Report 2011 Edition: The PVC Roofline Industry in the UK & Republic of Ireland. Market & Forecasts to 2014

from the Belgian manufacturer Plastivan, however, third party customers did not consider these suppliers to pose a realistic constraint on the parties.

73. Overall the OFT considers that de novo entry is unlikely due to the economies of scale in manufacturing PVC roofline products and the consequent high investment costs and long duration before any new manufacturer would be profitable. The OFT also considers it unlikely that any expansion by existing manufacturers would be sufficient to counter the prospect of an SLC and notes that the number of firms and lines within the market has been shrinking over the last five years. Therefore, the OFT does not consider entry or expansion would be timely, likely or sufficient to counter the realistic prospect of an SLC in the manufacture and supply of PVC roofline products.

EFFICIENCIES

74. A merger may create efficiencies that enhance rivalry, such that the merger does not give rise to an SLC.[39] Epwin submitted that it will seek efficiencies by the combined operation of the two parties, however the OFT notes that this is in relation to window profile systems and frame fabrication in particular, as opposed to PVC roofline products where the OFT considers there to be a realistic prospect of an SLC. The parties also submitted that 'the merger aims to achieve efficiencies in production and technology that will reduce costs and improve competitiveness in order to stabilize the Latium business and maintain employment.'

75. The OFT notes that the above efficiencies are not quantified and that there is no evidence that they will enhance rivalry or result in relevant customer benefits.

THIRD PARTY VIEWS

76. Third-party comments have been discussed above where relevant. The OFT received responses from customers and competitors and there was a significant level of concern from both. Customers generally considered the parties to be close competitors and many raised concerns about price rises, whether with regard to the supply of PVC roofline products to independent stockists or the supply for directly negotiated contracts with large customers such as national house builders.

[39] *Merger Assessment Guidelines*, paragraph 5.7.2

ASSESSMENT

77. The parties' overlap in the production and supply of various products including window profiles, glass sealed units, rainwater components, and other roofline products extruded from PVC such as soffit boards, fascia and cladding. Epwin also operates its own chain of stockists supplying PVC based products to builders, roofers and installers.

78. The OFT examined the merger on the basis of the following candidate product markets: the manufacture and supply of window profiles, window frames, and glass sealed units, the manufacture of PVC roofline products such as fascia, soffits, cladding boards and PVC window trims including the supply to independent stockists and to roofers and builders through directly negotiated contracts, and the manufacture of PVC rainwater products such as guttering, pipes and connecting joints. With the relevant geographic frame of reference as the UK and ROI.

79. With regard to the manufacture and supply of window profiles, window frames, and glass sealed units the parties have a minimal overlap. The parties' estimated combined share of supply in each of these product areas is below [10-20] per cent with increments of less than [0-10] per cent. The OFT does not consider, on the basis of the available evidence, that concerns arise in these areas.

80. Likewise, in the manufacture of PVC rainwater products the merged entity estimate that it has a market share of less than [ ] per cent with an increment of less than [ ] per cent.[vii] Third parties did not consider the parties to be close competitors and raised no concerns.

81. The OFT identified three potential theories of harm relating to the impact of the merger; namely: the supply of PVC roofline products through directly negotiated contracts with roofers and builders; the supply of PVC roofline products to independent stockists; and potential vertical effects arising from the merged entities vertically integrated stockists.

82. The evidence received by the OFT indicates that for the manufacture of PVC roofline products the parties will be the leading supplier, with a combined share of between 35 and 45 per cent (increment 15-25 per cent). Third

parties considered that the parties, post merger, would be the largest supplier of PVC roofline products and that there were a limited number of competitors.

83. The OFT is mindful that there are various routes to market for PVC roofline products which involve differing dynamics and attributes. For example, in supplying directly to roofers and builders a supplier must have sufficient capacity, and volume to handle these contracts. For supply to independent stockists, the OFT's investigation has found that generally, not directly competing with the stockist is key. As such, the OFT has assessed the merger's affect on these routes to market.

84. In supply direct to roofers and builders through directly negotiated contracts, the available information suggested that the merger parties were by far the largest players in this sector, with indications from third parties that shares may be in the region of [55-65] per cent and could be up to [ ] per cent. Third parties considered the number of potential competitors for these larger contracts to be limited by the scale of production of the firms and the resources available for negotiating direct sales. In this regard the merger parties were considered to be each other's closest competitors. The evidence from third parties, and the parties' recent bids for contracts showed that only two other suppliers compete with them; Eurocell and Freefoam. However, the OFT found that [ ] and may not be a strong post-merger constraint on the merged entity. The OFT therefore considers that the merger gives rise to a realistic prospect of a SLC in the supply of PVC roofline products directly to roofers and builders for large contracts.

85. The merged entities both supply PVC roofline products to independent stockists who then sell these products on to roofers or builders. The available evidence indicates that the parties compete closely in the supply to these independent stockists. The OFT's estimates gave the merged entity a share of supply to independent stockists of some [55-65] per cent (increment [25-35] per cent). The OFT has found that while independent stockists will multi source, they are, in general, either unable or unwilling to be supplied by manufacturers who have their own stockists (especially if there is a manufacturer-owned stockist nearby). Even though Epwin does have its own stockists it is comparatively unusual in that it sells the large bulk of its PVC roofline products, an estimated [80-90] per cent, through independent stockists.

86. The OFT investigated whether independent stockists would have sufficient choice post-merger to switch supply if prices were to increase. Whilst the evidence suggested that switching costs are low, the data available to the OFT on capacity showed that there is little spare capacity in the industry to allow competitors to fulfill demand in the event stockists do wish to switch on a large scale (in order to prevent a post merger price rise). The OFT also assessed the extent to which a manufacturer with its own stockist network will supply independent stockists and general builder's merchants. While the OFT was able to identify occasions where this has occurred, the evidence pointed to supply restrictions where an integrated stockist was in geographic proximity to an independent stockist. The OFT therefore concluded that a number of independent stockists would face a reduced choice of supplier after the merger which may raise competition concerns.

87. The OFT considered whether parties would have the ability to raise prices to roofers and builders directly or to independent stockists after the merger. It found that both firms earn gross profits of [ ] per cent, which have [ ] (the period over which data are available to the OFT). The OFT also applied a simple pricing model to the available evidence and found that there may be capacity constraints in this market and that this could lead to upward pricing pressure. Taken with other evidence on shares of supply, closeness of competition and relative strength of competitors, these factors indicate that competition may be weak and unilateral effects may be more likely to arise as a result of the merger.

88. The OFT considered the merged entity's ability to raise prices to downstream rivals (that is, other stockists), their incentive to do so, and the effect of this action. However, based on the available evidence, the OFT considers that the merged entity's has a limited incentive to raise prices to independent stockists based on the likely ability to recoup lost sales through increased sales at their own stockists. Therefore the OFT does not believe that there is a realistic prospect of an SLC arising from vertical effects.

89. Third parties were generally concerned about the merger, regarding the parties to be each other's main alternative supplier, particularly with regard to supply to house builders and social housing bodies.

90. The OFT considers that de novo entry is unlikely due to the economies of scale in manufacturing PVC roofline products and as such the high investment costs and long duration before any new manufacturer would be profitable.

The OFT has also noted the loss of extrusion lines and firms over the last five years and therefore considers it unlikely that any expansion by existing manufacturers would be sufficient to counter the prospect of an SLC. Therefore the OFT does not consider entry or expansion would be timely, likely or sufficient to counter the realistic prospect of an SLC in the manufacture and supply of PVC roofline products.

91. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

92. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.

[i] For the purpose of this decision this should read 'The Latium companies.'
[ii] The parties have clarified that it is not more time consuming to produce these products.
[iii] The OFT based its calculations of the parties' share of rainwater products on an internal document which indicated that the parties overlapped in this area. The parties have since clarified that they do not overlap in the supply of rainwater products and that the internal document referred to a wider set of products.
[iv] The parties have since confirmed that they have no such supply contracts with stockists.
[v] The D&G Consulting report makes no assumptions as to the split between manufacturer's supply to integrated and independent stockists.
[vi] See end note v.
[vii] See end note iii.