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## Anticipated acquisition by IKO UK Limited of The Waterproofing Group plc

The OFT's decision on reference under section 33 given on 30 June 2006. Full text published 13 July 2006.

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

### **PARTIES**

1. **IKO UK Limited** is a UK company and the parent of IKO Limited, a UK company specialising in the manufacture and supply of bituminous waterproofing roofing products and other products for the building industry. This paper refers to both of these companies collectively as IKO. They are a part of the worldwide group IKO Sales Limited, based in Canada.
2. **The Waterproofing Group plc (WPG)** is a UK company which manufactures and supplies bituminous waterproofing roofing products. Some of its products are traded using the Marley Waterproofing brand. Its UK turnover for the year to 31 December 2005 was around £20 million.

### **TRANSACTION**

3. IKO proposes to acquire the entire issued share capital, and any shares issued pursuant to the exercise of outstanding options and warrants, of WPG.

### **JURISDICTION**

4. The OFT is satisfied that arrangements are sufficiently in progress which will lead the enterprises, IKO and WPG, ceasing to be distinct.
5. The parties combined share of supply exceeds 25 per cent in the UK for the supply of: (i) bituminous flat roof coverings; (ii) pitched roof underslatings; and (iii)

damp-proof courses. Consequently, the share of supply test set out in section 23 of the Enterprise Act 2002 (the Act) is met.

6. Therefore, the OFT considers that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **RELEVANT MARKET**

7. The parties overlap in the manufacture and supply of bituminous roofing coverings for use on flat roofs, bituminous underslatings, damp-proof courses (DPCs), and damp-proof membranes (DPMs).<sup>1</sup>

### **Product scope – flat roof coverings and pitched roof underslatings**

#### **Flat roof coverings**

8. Roof coverings are applied to roofs in order to waterproof them. These can be bituminous roof coverings, or use other material of varying quality, life span and cost: metal, single ply (plastic) membranes, mastic asphalt, 'hot melt' (polyester and bitumen), and various cold applied liquid coverings.
9. Bituminous flat roof coverings (also called roofing felts or roofing membranes) are mainly rag-based (these have relatively short lifespan and are used on garages and sheds), glass-based or polyester-based (which are high quality and long lasting). They can also be distinguished by the type of bituminous coating used. Low quality oxidised bitumen is generally used with rag- and some glass-based felts and polymer-modified bitumen is used on polyester and glass felts.
10. The parties submitted to the OFT that all types of bituminous flat roof coverings are in the same frame of reference, further, that the product frame should also include single ply membranes and liquid applied coverings. In addition, the parties submitted that some metal roof coverings exerted some competitive pressure on bituminous coverings.
11. The Competition Commission (CC) previously considered that bituminous coverings were not in the same market as other coverings but that there was some demand side substitution between the various types of bituminous coverings and almost complete supply side substitutability.<sup>2</sup>

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<sup>1</sup> Flat roofs are defined as roofs which are pitched up to five degrees.

<sup>2</sup> Competition Commission, Icopal Holding A/S and Icopal a/s: a report on the merger situation, Cm 5089, April 2001.

12. In the current case the OFT has found some evidence that single ply membranes are being used as an alternative to some bituminous coverings in some instances.<sup>3</sup> However, most third parties (both customers and competitors) who responded to the OFT's investigation said that a hypothetical price increase of 5-10 per cent would not result in significant switching to other coverings.
13. The OFT has not found it necessary to conclude on whether single ply membranes are in the same product market as bituminous coverings as such a conclusion does not change the outcome of the competition assessment.

#### Pitched roof underslatings

14. Pitched roof underslatings ('underslatings') are sheets which are placed under pitched roof coverings (such as tiles or slates) in order to keep out water and dirt. The most common types are bituminous sheets, plastic non-breather sheets and plastic breather membrane.
15. The parties in this case agree with the CC approach of considering that all types of underslatings are demand side substitutes and that they are supply side substitutes with bituminous flat roof coverings.<sup>4</sup>
16. In the current case the OFT has analysed the proposed merger on the basis of all pitched roof underslatings and all bituminous flat roof coverings.

#### **Geographic scope – flat roof coverings and underslatings**

17. The parties submitted to the OFT that the relevant geographic scope for bituminous roof coverings and underslatings is EU wide because importers from the EU do not seem to suffer any cost disadvantage relative to UK suppliers, and imports of bituminous membranes have been increasing recently.<sup>5</sup> The parties estimated that ten of the top sixteen suppliers of high performance bituminous coverings imported the products from Germany, Italy, France and the USA, and around two-thirds of plastic underslatings are imported (UK suppliers tend to concentrate on bituminous underslatings).

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<sup>3</sup> The AMA market research report says single ply membranes have gained market share at the expense of bituminous coverings (AMA Research Limited: Roofing Market UK 2005, August 2005, p.52). From 2004 to 2004, waterproof coverings as a whole increased by 10 per cent (by volume) whereas bituminous coverings increased by a little over one per cent and single ply membranes increased by 15 per cent (liquid applied systems increased by almost 50 per cent) (MSI Marketing Research for Industry Limited: Roofing Materials UK, April 2005, p.18).

<sup>4</sup> The CC considered it was easy to switch between the manufacture of bituminous coverings and bituminous underslatings.

<sup>5</sup> By 28 per cent over the 2000–04 period.

18. In its 2001 report the CC considered the geographic market to be at least UK wide. This was because imports tended to be concentrated in the higher value products such as glass- and polyester-based bituminous coverings with polymer coatings, and plastic underslatings. There was very little importing of rag-based coverings. The CC did not expect a moderate increase in the price of bituminous coverings would result in substantial imports from mainland Europe.
19. In the current case, the OFT has found that in 2004 around 12 per cent of bituminous coverings were imported.<sup>6</sup> Without prejudice to the possibility that the relevant geographic scope could be wider than the UK, the OFT has taken a cautious approach and analysed the proposed merger on a UK wide basis.

**Product scope – damp-proof courses and damp-proof membranes**

20. DPCs and DPMs are waterproof sheetings which are placed within the fabric of a building to prevent water from rising up through the walls (if DPCs) or floors (if DPMs) of a building. Standard DPCs are made from oxidised bitumen or polythene, while high performance DPCs are made from various polymeric materials or modified bitumen on a polyester base. DPMs are made from either polythene or from a range of polymeric materials.
21. The parties argued, and the majority of third parties agreed, that DPCs and DPMs should be considered to be in the same frame of reference because many DPCs are not only made from the same materials as DPMs, but on the same machinery. Thus, supply side substitution could easily occur in a timely manner by simply adjusting the thickness of the sheets (DPCs and DPMs are of a different thickness) and adding a slitting machine.
22. The parties also contended that the major suppliers to UK customers (IKO, WPG, Icopal and Visqueen) already supply both DPCs and DPMs.<sup>7</sup> The parties gave an example of IKO DPCs and DPMs being manufactured on the same manufacturing line.<sup>8</sup>
23. In 2001 the CC did not consider whether DPCs and DPMs were in the same product market (it only considered DPCs separately). However, it did consider all DPCs to be in the same product market.
24. In the current case the OFT does not consider it necessary to conclude on whether DPCs and DPMs form a relevant product market as such a conclusion

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<sup>6</sup> AMA Research Limited, Roofing Market UK 2005, tables 23 & 29, and chart 25. However, the research report does not indicate where the products are imported from.

<sup>7</sup> Visqueen Building Products is a subsidiary company of British Polythene Industries plc.

<sup>8</sup> IKO's Pluvex DPC, Gastite DPC and Plasprufe DPM.

does not change the outcome of the competition assessment. The OFT has decided to take a cautious approach and analyse the proposed merger on the basis of all DPCs and DPMs both separately and together.

#### **Geographic scope – damp-proof courses and damp-proof membranes**

25. In 2001 the CC considered the geographic scope for DPCs to be UK wide. The parties agreed with this assessment and the OFT did not receive any evidence to the contrary.
26. The OFT has examined the proposed merger in regard to DPCs and DPMs on a UK wide basis.

#### **HORIZONTAL ISSUES**

##### **Flat roof coverings and underslatings**

27. The merger will bring together two of the three largest UK suppliers of these products. The merged entity will have about [20-30] per cent of the supply of flat roof coverings and underslatings in the UK (increment about [5-15] per cent).<sup>9</sup> By segments, their shares vary from about [20-30] per cent (increment about [10-20] per cent) of bituminous coverings to [40-50] per cent (increment [10-20] per cent) for bituminous underslatings.
28. The CC in 2001 cleared the Icopal merger (where the shares of supply involved were greater than 40 per cent) on the basis of effective current and potential competitors (both domestically and from abroad), as well as the presence of countervailing buyer power.
29. In the current case the shares of supply are lower and the OFT believes that there will be effective competition facing the merged entity after the merger, from domestic suppliers with one supplier having about [20-30] per cent share of supply (and [20-30] per cent in each of the segments of the supply of bituminous felts, bituminous underslatings and plastic underslatings) and two other domestic suppliers at about [10-20] per cent each.
30. The parties and third parties have both indicated that potential competition also exists on the basis that UK rivals have spare capacity and that there are growing imports of bituminous coverings and underslatings into the UK. Some 40 per cent of polyester-based bituminous coverings are imported as are around two-thirds of plastic underslatings.

## **Damp-proof courses and damp-proof membranes**

31. There is a significant difference to the parties' position when DPMs are included in the frame of reference (about [15-25] per cent, increment about [1-10] per cent by value) from when the definition only includes DPCs (about [55-65] per cent, increment about [15-25] per cent by value).<sup>10</sup>
32. Both IKO and WPG are stronger in the supply of DPCs than they are in the supply of DPMs. Indeed, internal documents supplied by the parties show that WPG is a strong competitor to IKO in the supply of DPCs.
33. However, third parties told the OFT that there are two major suppliers who are effective competitors to the parties. One supplied about [55-65] per cent of DPMs in the UK in 2004 and almost half of DPMs and DPCs together.<sup>11</sup> Thus, it offers strong competition to both IKO and WPG in the supply of these products. The other supplied about [15-25] per cent of DPCs and about [10-20] per cent of DPMs.
34. Pricing data shown to the OFT reveal that prices for IKO's high performance DPCs fell during the period in which the larger supplier noted above and other smaller suppliers increased their shares of supply of DPCs. Both IKO and WPG lost shares during this period.
35. The parties argued that barriers to entry to the supply of DPCs and DPMs are low, as a supplier of one could easily switch to supply the other and any plastic sheeting manufacturer could enter.<sup>12</sup> One third party manufacturer told the OFT that there were no technical barriers preventing them from doing so. This is also supported by the entry and expansion in recent years of the largest supplier of DPMs and both DPMs and DPCs combined, as well as smaller suppliers .
36. There may also be countervailing buyer power. The vast majority of DPC sales in the UK are made through specialist distributors and builders' merchants. The CC found that many of these were substantial, nationwide groups with a sophisticated approach to procurement and considerable buying power, with consequent pressure on wholesale prices The parties have submitted to the OFT that consolidation in both of these channels has increased countervailing buyer

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<sup>9</sup> The figures are based on 2004 data.

<sup>10</sup> In the sub-segment of high performance DPCs, together the parties supplied [60-70] per cent (by value, [50-60] per cent by volume) in 2004.

<sup>11</sup> The figures are based on value. However, they do vary between value and volume. For example, although Visqueen supplied [10-20] per cent by value of all DPCs in 2004, by volume that figure becomes [25-35] per cent.

<sup>12</sup> Although the parties did not suggest that all plastic sheet manufacturing should be included in the relevant product market definition.

power and in part explain the recent price falls for DPCs. The larger respondents to the OFT's questions in this case broadly confirmed that they would be able to resist hypothetical post-merger price increases given their ability to switch, or threaten to switch, to alternative suppliers. One commented that in the past it had switched between suppliers quickly where it felt it could get a better deal.

### **THIRD PARTY VIEWS**

37. Because of the different possible product markets and the different distribution channels used by the parties, the OFT spoke to a very large number of customers and competitors. Most third parties were unconcerned about the proposed merger. Many customers thought that sufficient competition would remain for them to switch suppliers in the event of price increases. Others considered that they possessed sufficient countervailing buyer power to resist any price increases.
38. Certain customers expressed concerns. Some were concerned about the potential loss of choice in bituminous coverings while others were concerned about the potential loss of capacity (and whether any other producers could supply the volumes that they required). Some third parties were concerned that the merged entity would have the ability to raise prices. One third party customer was concerned that the merger will bring together the only two significant suppliers of pitch polymer DPCs. Each of these concerns have been addressed in the discussion above.

### **ASSESSMENT**

39. For bituminous coverings and underslatings, the OFT considers that although the merger is of two of the largest suppliers (at about 25-45 per cent share) effective competitive constraints will remain (particularly from one supplier at [25-35] per cent share) and that potential competition provides a constraint in the form of low barriers to entry and expansion.
40. For DPCs and DPMs, the structure of supply is considerably more concentrated than for bituminous coverings and underslatings. Despite this, if DPMs are included in the market definition the proposed merger does not present competition concerns (the increment is small). By analysing DPCs separately the OFT considers that after the merger two major suppliers will continue to place a competitive constraint on the merged parties. In addition, barriers to entry and expansion are low and a degree of countervailing buyer power is present.
41. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

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