
Anticipated acquisition by Norbord NV of the Genk Mill of Agglo NV

The OFT's decision on reference under section 33 given on 13 August 2004

PARTIES

1. **Norbord NV (Norbord)** is a Belgium subsidiary of Nexfor Inc. Norbord manufactures and supplies different types of panelboard namely: i) particleboard ii) medium density board iii) oriented strand board and iv) faced board products. In 2003, Nexfor's UK turnover was £145.5m, of which £ [] million was attributed to oriented strand board and £ [] million attributed to particleboard (see note 1).
2. **Agglo NV (Agglo)** is a subsidiary of a Belgium company Interlin Invest NV. Agglo owns the **Genk Mill** in Belgium which produces particleboard and oriented strand board. In 2003, Genk Mill's UK sales for [both products was less than £70 million](see note 2).

TRANSACTION

3. Norbord proposes to acquire the Genk Mill as a going concern from Agglo, together with approximately 200 staff and the benefit of existing contracts. The transaction is an acquisition of assets and not of shares. Accordingly, there will be no change in the ownership of Agglo. The transaction was notified to the OFT by merger notice on 5 July 2004 and the statutory deadline is 16 August 2004.

JURISDICTION

4. As a result of this transaction Norbord and the Genk Mill and associated business of Agglo will cease to be distinct. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met in respect of the supply of oriented strand board in the UK. The OFT therefore believes that it is or may be the case that arrangements are in progress which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

5. The parties overlap in the supply of oriented strand board (OSB) and particleboard both of which are types of panelboard.

Product scope

6. OSB is a multi-panel board primarily produced (90 per cent) from Scots Pine pulpwood logs. It is made from strands of wood of a pre-determined shape and thickness bonded together with an adhesive. OSB is primarily used for construction purposes e.g. flooring, flat roof decking, internal walls, hoarding, shop-fitting and wall sheathing (see note 3). Different grades of OSB are available for different levels of weight bearing and different environmental conditions. These are:
 - OSB/1 which is a base level general purpose panel for interior fittings and furniture use;
 - OSB/2 which is the normal choice panel for interior use with some load bearing capability;
 - OSB/3 which is commonly used in construction and can be used in humid conditions; and
 - OSB/4 which is a heavy duty panel for load bearing in humid conditions.

The vast majority of OSB sales in the UK and Europe are of OSB/2 and OSB/3. Neither of the parties produces OSB/1 or OSB/4.

7. Particleboard is a panel material manufactured under pressure and heat from particles of recycled wood (such as wood flakes, chips, shavings and sawdust) with the addition of an adhesive. It is primarily used for structural (parties estimate 20 per cent) and non-structural applications (parties estimate 80 per cent), e.g. furniture, worktops, 'do-it-yourself', flooring, and roofing (see note 4).

OSB

8. On the demand side, Norbord submits that OSB is substitutable with other types of panelboards e.g. particleboard, plywood, hardboard, MDF and sawn timber. Third party responses indicate that substitution depends on the application, but the closest substitute is plywood. One respondent submitted that OSB and plywood are interchangeable, and another third party maintained that the relative price between OSB and plywood influences switching decisions. Norbord's internal documents also state that OSB growth in Western Europe has been primarily driven by substitution of plywood and particleboard in structural building applications as well as continued growth in the share of timber frame and

prefabricated house construction. Some customers, however, indicated that if the price of OSB increased by 5-10 per cent they would accept it.

9. On the supply side, Norbord submits that although particleboard, MDF and OSB are manufactured using similar techniques, different production lines and equipment are needed. Switching a production line to OSB would cost tens of millions of Euros. Third parties agree that supply side substitution is unlikely.
10. In light of these responses, the OFT considers it appropriate to treat OSB separately from other panelboards for the purposes of identifying the appropriate frame of reference to assess the competitive impact of this transaction.
11. With regard to the different grades of OSB, one third party submits that there is a demand side distinction between OSB/2 and OSB/3 as they are used for different applications. Norbord agrees that most customers purchase the appropriate grade for their intended application; however, there may be some substitution to higher grades, e.g. OSB/2 can be substituted with OSB/3. On the supply side, Norbord submits that the difference in production costs between OSB/2 and OSB/3 is [less than £10 per m³] (see note 2). It is very easy for manufacturers to switch between these two grades with no additional machinery being required. Norbord itself switches, sometimes from one day to the next, in response to changes in price and demand for one grade over another. The ease and rapidity of switching between different grades of OSB suggests that it is appropriate to consider all grades of OSB under the same frame of reference.

Particleboard

12. Norbord submits that particleboard can be substituted with OSB, plywood, hardboard, MDF and sawn timber but maintains that it would take more than a 10 per cent price increase before switching would take place. Even with a 10 per cent increase in price, particleboard is still cheaper than its substitutes. This is supported by third parties. Although there are similarities in the production process of panel boards, especially between particleboard and MDF, Norbord and respondents submit that supply side substitution would not occur.

Geographic scope

13. 54 per cent of OSB and 29.6 per cent of particleboard is imported into the UK from Belgium, Bulgaria, France, Germany, Finland, Ireland, Luxembourg and Poland. Transport costs account for approximately 10 per cent of the resale price and there are no European trade barriers in terms of tariffs and regulatory requirements. All third parties took the view that the geographic scope of supply is European.

14. For the purposes of this assessment the appropriate frames of reference are considered to be the European manufacture and supply of i) oriented strand board and ii) particleboard.

HORIZONTAL ISSUES

Oriented Strand Board (OSB)

15. The parties post merger European supply of OSB capacity will be [15-25 per cent] (increment of [0-10 per cent]) (see note 5).
16. Post-merger, five competitors remain and the presence of Kronoswiss Group with a [30-40 per cent] share of supply is likely to place a constraint on the merged entity. Norbord provided the Office with bid data for significant bids (see note 6) for the last three years. This indicates that for OSB, Norbord mainly competes with Smartply and Kronoswiss Group which suggests that the parties' are not close competitors for large contracts. (see note 5).

Particleboard

17. Post-merger, the parties' combined European share of supply for particleboard capacity is [0-5 per cent], (increment [1-5 per cent]). Norbord submits that there are a large number of mills (over 200) operating in Europe. Norbord estimates that the top five suppliers are: Kronospan, Egger, Sonae, Pfleiderer and Kronoswiss Group each with a 5-10 per cent share of total European capacity. All the remaining producers have less a than5 per cent share. With a minimal accretion to share of supply and numerous active suppliers, the OFT does not believe that any competition concerns in respect of the supply of particleboard will arise. (see note 5).

Co-ordinated effects

18. OSB is a relatively homogenous product and prices are transparent. These elements could be conducive to providing suppliers with the ability to align terms of co-ordination but the number of suppliers active in the market may inhibit their ability to respond to cheating. However, third party responses submit that the OSB demand has steadily increased over the past five years with demand almost doubling in that time. Further evidence has also shown fluctuating costs and prices have frequently not covered costs. Norbord submits that capacity has also increased by approximately two thirds since 1998 (see Barriers to entry below). Due to no history of previous co-operation, a dynamic sector and alternative competitors present, the incentives for co-ordinated behaviour would not be expected to arise as a result of the merger.

Barriers to entry and expansion

Oriented Strand Board

19. In order to supply OSB a new entrant would need a mill, staff and training. Norbord submits that the mill needs to be relatively large and located close to a suitable wood resource. For set up costs, Norbord estimates that it would cost approximately £26-33 million to acquire a 5 per cent share of the European sector (annual output of 100.000 m³/year) (see note 7) and 20-30 per cent of costs are sunk.
20. There is evidence of new mill construction. Competitors submit that new entry has occurred in Bulgaria, Germany and France. Approximately seven suppliers have entered and investment was expected in Eastern Europe due to lower operating costs. Norbord maintains that since 1998 capacity through the construction of new mills has increased by 1,900,000 m³/year and this accounts for two thirds of the current capacity level. This appears to be existing manufacturers expanding production. Entry costs do not seem to be insurmountable as evidenced by the level of new entry.

Particleboard

21. Norbord submits that the construction of a particleboard mill in principle costs the same as the construction of an OSB facility. However, it submits that large quantities of used particleboard manufacturing equipment are available and in addition the raw woodfibre materials required for particleboard can be sourced from a wider range of sources. The cost per m³ is lower than OSB. Third parties maintain that costs are similar to the set up of an OSB mill and entry has occurred in central Europe.

Buyer power

22. Norbord maintains that the main customers of OSB and particleboard are large timber and builder merchants which represent approximately 50 per cent of their sales and therefore hold countervailing buyer power. The majority of third parties submitted customers did have negotiating strength due to the size of purchases and the number of available suppliers.

THIRD PARTY VIEWS

23. Customers, including customers of Norbord and Agglo, were generally unconcerned.

ASSESSMENT

24. The parties overlap in the European manufacture and supply of certain types of panel board, specifically oriented strand board (OSB) and particleboard. The merged entity will become the second largest manufacturer and supplier of OSB in the European market with a share of supply of [15-25 per cent] (increment [0-10 per cent]). The share of supply of particleboard remains relatively modest (see note 5).
25. The merged entity will continue to face competition from five other major suppliers of OSB and particleboard. An effective constraint on the merged entity is expected to come from these other major suppliers in the European market.
26. The markets for OSB and particleboard are competitive with evidence of new mill construction. In addition, the evidence suggests that demand for OSB has steadily increased over the past five years. Although OSB and particleboard pricing is relatively transparent and the products are homogenous, given the evidence of price and cost fluctuations and the number of suppliers that remain in the market the OFT is of the view that co-ordinated effects would not be expected to materialise as a result of the merger in question.
27. Further, bid data for the last three years shows that for the OSB product, Norbord mainly competes with Smartply and Kronoswiss Group. This suggests that the parties to the merger are not close competitors for large contracts.
28. 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

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

NOTES

1. Text removed for reasons of commercial confidentiality at the request of the parties.
2. Exact figures removed at the request of the parties.
3. Keynote report 'Timber & Joinery' 2003.
4. Keynote report 'Timber & Joinery' 2003 page 2 and 65.
5. Exact figures in this paragraph replaced by ranges at the parties request.
6. Significant bids are defined as bids for volumes amounting to 2 per cent or more of Norbord's annual output of the particleboard and OSB.

7. Converted €40- 50 million. Norbord submits a recent OSB mill, which produces over 300,000 m³/year capacity has been built in excess £66 million (€100 million).