
ANTICIPATED ACQUISITION BY HONEYWELL INTERNATIONAL INC OF THE HYMATIC GROUP LIMITED

The OFT's decision on reference under section 33 given on 17 December 2003

PARTIES

1. **Honeywell International Inc** (Honeywell) is an advanced technology manufacturing company incorporated in the USA and operating world-wide through four divisions: Speciality Materials; Transportation and Power Systems; Automation and Control Solutions; and Aerospace Solutions. It is a major supplier of equipment and systems to the aerospace sector. In 2002 Honeywell achieved turnover in the UK of [] (see note 1) and worldwide turnover of \$22,274 million (£14,805m). **The Hymatic Group Ltd** (Hymatic) is a UK based company majority owned by the venture capital company 3i. It designs, manufactures and overhauls components and systems, principally for use in aerospace and defence markets. Hymatic operates in three main areas: Joule-Thomson Cryogenic Coolers; Stirling Cycle Cryogenic Coolers; and Fluid Control, including aerospace components. In 2002 Hymatic had a world-wide turnover of £21.7 million, of which £13.1 million was achieved in the UK.

TRANSACTION

2. Honeywell proposes to buy the entire issued share capital of Hymatic for an initial consideration of approximately [] (see note 1), followed by an adjustment contingent on the level of future sales of certain Hymatic products. The 40 day administrative deadline is 5 January 2004. The merger has also been notified in Italy and Germany. It has already been considered and cleared by Germany.

JURISDICTION

3. As a result of this transaction arrangements are in progress or in contemplation which if carried into effect will result in the creation of a relevant merger situation under sections 33(1)(a) and 23 of the Enterprise Act 2002 (the Act) whereby Honeywell and Hymatic will cease to be distinct. The parties overlap in the supply of aerospace components and the share of supply test in section 23 of the Act is met in respect of the supply of control valves and anti-ice valves for use in the aerospace industry in the UK. A relevant merger situation is therefore likely to be created.

RELEVANT MARKET

Product market

4. The principal overlap between the parties is in the manufacture of valves for use in Environmental Control Systems (ECS) discussed below. There is also a limited overlap in the manufacture of water extractors (for use in ECS) and hydraulic solenoid valves (not used in ECS). [] (see note 1) and the limited share of Hymatic in the sales of each of the two components of less than 5 per cent on an EU basis and less than [0-5 per cent] (see note 2) on a worldwide basis, these overlaps will not be considered further.
5. Both parties are active in the manufacture and sale of components required in the construction of ECS for aircraft. An ECS generally performs four functions comprising the regulation of the provision of 'bleed air' for: the air-conditioning system from the engine; cabin air-conditioning; cabin pressure control; and anti-ice systems which prevent ice from forming on the wings.
6. When an aircraft manufacturer ('airframer') procures an ECS for use in a new aviation programme it has three choices:
 - a let a single contract for the entire ECS system (with the successful bidder having the option to sub-contract where necessary);
 - b buy in the four separate sub-systems making up the ECS and knit these together in-house;
 - c purchase all of the components required for use in the ECS and produce the systems using in-house engineering capacity.
7. Honeywell has the expertise and capability to produce entire systems, and to bid for contracts let according to any of the above options. Hymatic has the capability to produce valves, so is able to bid only for contracts for component parts. This may involve sales direct to the OEM ((c) above), or sub-contracting of work taken on by producers of systems or sub-systems ((a) above).

Demand-side substitutes

8. There is an increasing trend towards the procurement of complete ECS systems, and many OEMs have cut their engineering capacity as a result. These customers would only be able to switch to the use of components or sub-systems instead of systems after significant investment, though customers buying components are able to switch to systems. Hence possibilities for demand-side substitution for OEM customers are limited. As regards sub-system suppliers the possibilities are to vertically integrate or purchase components from valve manufacturers.
9. With regard to different types of valve, these are often designed specifically for a project. Hence, once the specification has been set there may not be substitutability between this and other commercially available valves. At the design stage, however, there is substitutability between suppliers.
10. Spares and maintenance for an ECS system are typically provided by the original provider of the component or system. Terms for such aftermarket work are typically set out in the original tenders for the ECS contract.

11. Honeywell submits that the supply of ECS systems and sub-systems for use in civil and military aircraft fall into the same economic market as the technological requirements of each are fundamentally the same. This has been supported by third parties.

Supply-side substitutes

12. Vertically integrated suppliers of ECS systems typically have the capacity to produce all of the components they need in-house, though many choose to sub-contract in specific circumstances. Hence suppliers of systems can switch to providing sub-systems or valves. Significant investment would be required to increase the level of the supply chain at which a firm is operating (e.g for a valve supplier to begin supplying ECS systems), and this is not feasible within the time scales involved in the concept of 'supply-side substitution'.

Geographic market

13. The parties and third parties have confirmed that valves and ECS systems are bought and sold on a global basis. Customers look to the whole range of suppliers available to them and the major producers of valves have similar shares of supply on both an EU and global basis. There is some difference in the data for the UK, but Honeywell considers this is due to the small number of contracts being bid for in the UK, so success in these contracts skews the figures.

HORIZONTAL ISSUES

Shares of supply

Table one: Shares of supply of the sale of aerospace valves - Worldwide

Product	Total market size (£m)	Honeywell Share of sales	Hymatic share of sales	Combined share
Bleed valves	[](see note 1)	25-35%	0%	25-35%
Control valves	[](see note 1)	20-30%	0-5%	25-35%
Anti-ice valves	[](see note 1)	10-20%	0-5%	15-25%
Solenoid valves	[](see note 1)	15-25%	0%	15-25%
All aerospace valves	[](see note 1)	20-30%	0-5%	25-35%

Source: The parties. See note 2.

Notes: Shares of supply are for valves sold as such on the open market, so do not include components produced in-house and incorporated in sub-systems and systems. However, the figures are changed only slightly if such production is included: for control valves the combined share is 25-35 per cent (increment 0-5 per cent) and for anti-ice valves it is 15-25 per cent (increment 0-5 per cent) (see note 2).

Table two: Shares of supply of the sale of aerospace valves - UK

Product	Total market size (£m)	Honeywell Share of sales	Hymatic share of sales	Combined share
Bleed valves	[](see note 1)	35-45%	0%	35-45%
Control valves	[](see note 1)	35-45%	0-5%	40-50%
Anti-ice valves	[](see note 1)	0-10%	25-35%	35-45%
Solenoid valves	[](see note 1)	15-25%	0%	15-25%
All aerospace valves	[](see note 1)	20-30%	0-10%	30-40%

Source: The parties. See note 2.

Notes: Shares of supply are for valves sold as such on the open market, so do not include components produced in-house and incorporated in sub-systems and systems. However, the figures are changed only slightly if such production is included: for control valves the combined share is 40-50 per cent (increment 0-5 per cent) and for anti-ice valves it is 35-45 per cent (increment 0-10 per cent) (see note 2).

Table three: Shares of supply of aerospace valves – Worldwide/UK

	World-wide	UK
Honeywell	20-30%	20-30%
Hymatic	0-5%	0-10%
Combined	25-35%	30-40%
Hamilton Sundstrand	20-30%	0-10%
Liebherr	15-25%	0-10%
Whittaker	0-10%	0-10%
Dukes	0-10%	0-10%
Parker	0-10%	-
Cobham*	-	10-20%
Dunlop*	-	10-20%
Others *(included in others for world-wide)	0-10%	0-10%

Source: The parties See note 2.

14. It is evident from the tables above that Honeywell will have a share of supply of 30-40 per cent (increment 0-10 per cent) (see note 2) of all aerospace valves sold in the UK post-merger, though the portfolios of the parties are largely complementary in nature. The parties' combined share on a world-wide basis is lower at 20-30 per cent, with an increment of just 0-5 per cent (see note 2). There are a number of substantial world-wide suppliers of valves competing for contracts, as well as two operators with substantial shares in the UK only.
15. In addition to the relatively fragmented nature of the marketplace, any loss of competition is limited by the slight difference in the product being supplied. The parties submit that they have only been in direct competition for valve contracts twice in the past ten years, as they tend to bid for slightly different contracts, with Honeywell focussing on more high-tech products than Hymatic. One third party has raised concerns that previously it was dual-sourcing from the parties, but post-merger it will not be able to continue this approach. There are, however, a range of other firms with the technological capability to produce such a component.
16. In addition, there is a growing trend for the acquisition of complete ECS systems by the airframer, for which there are three competitors world-wide, including Honeywell, currently bidding for contracts. At this systems level the transaction has no impact, as Hymatic has only a minimal presence in the manufacture of systems and sub-systems, and has never bid for a complete ECS system contract. Hymatic does service one system contract, a legacy contract gained through the acquisition of Hymatic by its previous owner.

17. Competition for these products takes place primarily at the time of tendering for contracts, as once a specific valve has been designed and used in an aircraft there are often no off-the-shelf alternatives available. Contracts take into account the after-market by including terms and conditions for re-supply in the up-front contract.

Barriers to entry and expansion

18. Financial costs of entry into the provision of valves appear to be relatively low, with estimates of entry costs ranging between £2 million and £10 million. The worldwide aerospace valve industry is worth in the region of [] (see note 1) annually. There may however be reputational needs to overcome for a new entrant. Entry into the provision of complete systems would entail considerably more cost, with estimates ranging from £15 million to £100 million, dependent upon the sophistication of the system the producer intended to offer. Reputation is also likely to be important, and hence new entry at this level is perhaps less likely. Given, however, that Hymatic does not supply complete systems it is not necessary to reach a conclusion on the extent of any barriers at this level of the supply chain.

Buyer power

19. The customers of the parties tend to be large, multi-national firms that are likely to be able to exert some buyer power. Sales are through bidding markets, with potential suppliers of a new programme asked to put forward proposals of how they intend to meet the airframer's technical specifications. Typically a short-list is drawn up before a second round of bidding produces an overall winner.

VERTICAL ISSUES

20. Hymatic is active at a level of the supply chain upstream of the activities of Honeywell in the provision of complete ECS systems. To the extent that Honeywell produces almost all of the valves it requires internally, this transaction does not represent additional vertical integration by Honeywell. Furthermore, a number of valve suppliers not vertically integrated into the production of systems will remain post-merger to act as a constraint, so that Honeywell will not be in a position to raise costs of rivals or airframers choosing to construct ECS systems in-house by increasing valve prices.

CONGLOMERATE ISSUES

21. Honeywell submits that the non-overlap products which it is acquiring from Hymatic, such as coolers and pressurisation systems primarily used in the defence and marine sectors, will not increase its ability to make use of portfolio power. The coolers are sufficiently different from the remainder of the Honeywell portfolio that it will not be able to exploit any market power by bundling these new products with its current offering. The pressurisation systems are relatively low-technology and could have been developed with minimal investment. This suggests that the prospect of conglomeracy issues arising is minimal.

THIRD PARTY VIEWS

22. The Office contacted third parties in the usual way. Customers typically raised few competition concerns about the merger and cited a range of alternative suppliers of valves they could use for their contracts. Competitors raised some concerns regarding the possibility of increased power of Honeywell and the difficulties for valve suppliers in finding markets for their products as the industry becomes increasingly orientated towards the purchase of complete ECS systems.

ASSESSMENT

23. The merger will result in Honeywell having a 20-30 per cent (see note 2) share of supply of valves for use in ECS systems in the aerospace industry on a world-wide basis, with an increment of only 0-5 per cent (see note 2). The increment arises only in respect of valves and not ECS systems since Hymatic is not an active competitor in the latter product. Third parties consistently argued that the correct geographic market definition for these products is global. A number of major suppliers remain post-merger providing a competitive constraint to the merged business. In addition, main customers are likely to be able to exercise some degree of buyer power in purchasing components and systems.
24. The OFT does not believe that it is or may be the case that the creation of the relevant merger situation may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services

DECISION

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

Notes

1. Text deleted at the request of the parties
2. Actual figures replaced by a range at the request of the parties