Competition & Markets Authority

JLA/WASHSTATION MERGER INQUIRY

Summary of hearing with Armstrong on 17 May 2018 at 11am to 12:30pm

Background of Amstrong's business

1. James Armstrong and Company Ltd (Armstrong) explained that it used to be a manufacturer and supplier of commercial laundry equipment, but ceased its manufacturing activities in 1982 when it moved from London to Newbury. Armstrong was taken over by the Hughes Electrical Group (Hughes) on 31 January 2018.

2. Hughes was a good fit for Armstrong because both are family businesses and operated within different areas in the UK (Armstrong in Scotland and in Newbury and Hughes are predominantly Midlands-based, coming out of East Anglia). Armstrong said that Hughes' activities were just complementary in the sense that they were domestic appliance retailers historically, of white goods and electrical products, and they had seen an opportunity in the commercial laundry market.

3. Armstrong started supplying higher education customers (HE customers) in 1993, but this has been a small business with £20,000-30,000 turnover per year and gradually built its customer base. In the last ten years the turnover from this business has declined.

4. The reason for the decline in sales has been twofold: first was the takeover of the JLA group and its subsidiary Circuit Laundrette, by HgCapital. Prior to that takeover, Circuit offered very low prices to numerous HE customers to gain contracts. This made it very difficult for Armstrong to compete. Secondly, there was the subsequent competition between Washstation and Circuit/JLA.

Industry background

5. Armstrong explained that the background of JLA's and Circuit's entry in the supply of managed laundry services to HE customers is important to understand the industry. Alistair Copley (AC), a very experienced salesman, left JLA and started Circuit Laundrette. AC imported the revenue sharing model from the US and grew market share very rapidly. AC was on very good terms with John Laithwaite, the former owner of JLA, from whom he bought machines and AC was bought out of Circuit by JLA, two or three years before HgCapital took over JLA.

6. Armstrong said that in the run up to the takeover of JLA by HgCapital, JLA offered very high commissions to HE customers to gain even more market share than they already had.

7. AC was banned for five years from selling to HE customers and once this period ended he started competing again for those customers with Washstation. Washstation competed very vigorously for HE customers and won a lot of customers from Circuit.

Higher education customers versus other customers of managed laundry services

8. Armstrong said that it was extremely unusual for large HE customers to ask for fixed rental agreements. The unique point of HE customers, which differentiates them from other customer types, is that they are in fact large hotels with captive customers. These conditions are not replicated in other sectors. HE customers do not want to get involved in the management issue of laundry services as it only accounts for a small proportion of the overall costs of providing accommodation.

9. Armstrong said that there are other customers that are interested in vend sharing (ie variable rental agreements where the customer receives a percentage of the usage fee paid by the student), but HE customers are the biggest opportunity. There are some housing associations interested in this, but the sheer traffic in HE customers is much larger. In the US there is an enormous business in apartment blocks' shared laundry rooms and vend sharing agreements, but these do not exist in the UK.

Competitive constraint imposed by Armstrong in the past and in the foreseeable future

10. Armstrong explained that it did not expand in the HE sector in the period after Circuit was purchased by JLA and prior to the entry of Washstation because customers had come to expect the high levels of commission which Circuit and JLA were offering. Armstrong was focussed in other areas within their business.

11. When questioned why Armstrong was not competing more strongly for HE customers in the subsequent period, Armstrong explained that the business case did not stack up for Armstrong. Armstrong would not find it worthwhile to compete with paybacks of 60-70% of turnover to the HE customers, which were offered by JLA and Washstation, as this would not have been profitable for Armstrong. Armstrong said it would be willing to change its bids to a certain extent, but not to the point that it becomes loss making.

12. More recently, Armstrong said that it saw the acquisition of Washstation by JLA as an opportunity. Service levels have dropped at JLA, and this meant that price, which is a very relevant parameter, has reduced in relative importance for customers.

13. Armstrong's offering has been relatively unchanged in terms of its service and commission levels. There has been a change in payment methods with cashless payment and also peripheral services such as the online viewing of machine status becoming more important and this is being incorporated in Armstrong's bids in university tenders.

14. Armstrong won two [✂] tenders recently, but was waiting to see whether its offering was also attractive to the red brick universities such as [✂], who usually ask for higher payback rates. While they are still waiting to see how the market reacts to their offering, Armstrong plans to compete for every HE opportunity that they are able to handle geographically.

15. When asked about whether the merger between Hughes and Armstrong has led to any improvements in its offering, Armstrong responded that it was now able to supply customers in areas in which it did not operate previously. For example, Armstrong submitted a bid in [✂] because Hughes was present there.

16. Armstrong said that, after the merger with Hughes, Armstrong can use more engineers from Hughes and that it will invest in extra engineers when it requires them.

Barriers to expansion

17. When asked whether there are there any other factors that constrain Armstrong's capacity to take on HE contracts, Armstrong said that it was going to find it challenging to gain market share and to make it sustainable. There are several tenders which are out, and Armstrong is keen to know how it has performed.

18. Armstrong said that the barriers to entry are high: obtaining machines, financing the initial outlay, building an engineering network. Goodman Sparks in Sheffield (they are an Armstrong dealer) had the same issues. As regards [✂], Armstrong worked with Goodman Sparks to supply that university. Most of the firms are regional players.

19. A company has to have a strong financial muscle to purchase the equipment. The sheer cost of the equipment, the installation and the upfront capex, could be refinanced on a lease basis with a finance house and otherwise it will take a considerable period to get that money back. There is also an element of speculation, as it is uncertain whether the revenues per year are as high as projected by the HE customer. They might also be lower.

20. Armstrong said that Alliance Laundry is the OEM manufacturer that supplies both JLA and Armstrong, which act as the dealers for Alliance machines in the UK. Miele and Electrolux machines are less suited for vending because they are or more for on-premise laundries such as hospitals.

21. One barrier a possible entrant could face is to obtain favourable prices for machines fit for vend sharing. Purchasing those machines from a local dealer is more expensive than directly from the OEM and most OEMs send a

potential purchaser to the local dealer. If a potential entrant would want to purchase from an OEM, it would probably need to buy a large quantity of machines and have a convincing business case. It is also not economical to convert a free-vending machine to a vending machine. It is however possible the other way around.

22. Armstrong also explained that university tenders for managed laundry services are usually concentrated at the beginning of the year, so that the machines can be installed in Summer before the new semester starts. This puts pressure on the available resources to install new equipment. Armstrong estimated that it will take Armstrong 5-10 years to fill the gap of Washstation. Armstrong has now probably [✄]% of the market.

23. When asked about whether there is any shortage of skilled engineers, Armstrong responded that this depends on the location and on the skill level. However, it is not really an issue to find new engineers. The only difficulty is that with a salary of around £[✄], Armstrong cannot afford to pay the commission levels of JLA/Washstation.

24. Armstrong said that the HE customer segment is not the most lucrative segment with rather small margins and it is not always certain whether the upfront costs (i.e. refurbishment and machines) and ongoing costs (i.e. servicing and maintenance) will be recouped. HE customers normally give a projection of what the level of use by students, and so revenue, will be. But these projections may be inaccurate.

25. When asked whether the uncertainty of revenue projections is a significant risk, Armstrong said that it would be if there is a large payback through commission in the agreement. For example, one university has a payback/commission of [✄]% and Armstrong's margin was around [✄]% and that is just about manageable.

26. Armstrong also gave as an example of sunk cost the requirement in a recent tender for a full refurbishment of all laundry rooms (including vinyl floors, which are very expensive).

27. These refurbishment requirements have become mainstream; universities have become more commercial in recent years and place much importance on the "student experience". Refurbishment is not very burdensome for a newly built room, but can be considerable.

28. When asked whether higher education customers would have any issues changing suppliers, Armstrong answered that it is difficult to expand from a low basis, and HE customers tend to go with the supplier they know. Armstrong is luckily known in the sector.

29. Armstrong said that the rates offered by Washstation were too low for a business to be run sustainably, and if Washstation had continued the way it did, it would have been impossible for another company to get a contract with a large HE customer competing against them.