Anticipated acquisition by RMIG Limited of Ash & Lacy Perforators Limited

ME/4166/09

The OFT's decision on reference under section 33 given on 26 August 2009. Full text of the decision published 22 September 2009.

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. **RMIG Limited** (**RMIG**) is active in the manufacture and supply of perforated metal, expanded metal and finished products derived from perforated metal. RMIG is a wholly-owned subsidiary of RM Rich Muller A/S, a company registered in Denmark and solely owned by the Rich Muller Foundation. In addition to RMIG in the United Kingdom, RM Rich Muller A/S has wholly owned subsidiaries in Austria, Belgium, France, Germany, Italy, the Netherlands, Norway, Poland, Spain, Sweden and Switzerland. In the financial year to 31 December 2008, RMIG Group had a turnover of €113.051 million and RMIG (in the UK) had a turnover of £9.6 million.

2. **Ash & Lacy Perforators Limited** (**A&LP**) is active in the manufacture and supply of perforated metal, expanded metal and fabricated architectural metalwork. A&LP is wholly-owned by Ash & Lacy Manufacturing Limited, a subsidiary of Hill & Smith Holdings plc (H&S). In the financial year ended 31 December 2008, H&S had a turnover of £419.8 million and A&LP had a UK turnover of approximately £[ ] million.

TRANSACTION AND TIMING

3. RMIG proposes to acquire A&LP. Following the merger, RMIG will fully integrate the target company and consolidate manufacturing into a single site in the United Kingdom.

4. The parties notified the proposed transaction on 1 July 2009, accordingly, the administrative target date for the OFT to announce a decision in this case is Wednesday 26 August 2009.

JURISDICTION

5. As a result of this transaction RMIG and A&LP will cease to be distinct. The UK turnover of A&LP does not exceed £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is not satisfied.

6. However, the parties' combined share of supply of perforated metal in the UK exceeds 25 per cent. It has been estimated to be approximately [65-75] per cent (according to RMIG's internal documents),[1] [55-65] per cent (according to A&LP's internal documents),[2] [45-55] per cent (including smaller specialist competitors),[3] or [40-50] per cent (as measured by number of presses, again including smaller specialist competitors).[4] Accordingly, the OFT believes that the share of supply test in section 23(2) of the Act is met.

7. The OFT therefore believes 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.

BACKGROUND

8. RMIG and A&LP are the two largest manufacturers and suppliers of perforated metal in the UK.

9. Perforated metal is manufactured by the process of metal stamping. Any type of metal can be perforated and metals often used for perforation include steel, aluminium, stainless steel, bronze, and brass. Perforated metal is used in a wide variety of applications in various sectors including industrial processing (for example, filters), food processing (for example, grain sorting), building and interior (for example, cladding, balustrades, and ceiling tiles), communications (for example, satellite dishes), household appliances (for example, washing machine drums and microwaves) and automotive and transport (for example, exhaust mufflers).

10. The manufacturing process for metal perforation involves punching or cutting a hole through the metal by using a press (of which there are

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[1] See paragraph 26.
[2] See paragraph 28.
[3] These shares exclude what the parties refer to as the 'competitive fringe' (see footnote 14 and paragraphs 55 to 58 below).
[4] See paragraph 32.

several types, that is, all-across, sectional press, narrow-strip and turret presses).[5] Once the metal is stamped, where the metal has some value, the burr (that falls away) is collected and sold as scrap metal.

MARKET DEFINITION

11. Both parties are active in the specialist manufacture and supply of perforated metal in the UK.[6]

Product scope

12. The parties submitted that the supply of perforated metal in the UK is the most appropriate relevant market in this case and there is no need to further segment the product market, for example, by sector or application, specification,[7] degree of product customisation,[8] or type of press equipment used to perforate the metal sheets.

13. On the demand side the parties argued that there is limited substitutability for perforated metal across different applications or degrees of customisation (for example, bespoke vs. standard perforated metal). Consistent with this, the OFT notes that some specialist suppliers of perforated metal in the UK tend to specialise in one or more sectors (for example, building and interior), or even in a certain application within a sector (for example, ceiling tiles within building and interior), mostly for historical reasons.

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[5] The parties explained to the OFT that there are four different types of press available to perforate metal. By far the largest and most expensive (at approximately £1.5 million) is the 'all-across' press which is normally built to order and can take 18 months for delivery. Its maximum width of perforation is 1500 millimetres, however, its main distinguishing factor is that it has no limits in terms of maximum material length, as it is able to perforate coiled metal. The 'narrow-strip' press, is similar to the 'all-across', however the maximum perforation width is approximately half the width, at 800 millimetres. The 'sectional' press is also a large press, normally used for heavier materials and costs approximately £700,000. It is able to perforate a maximum material width of 2500 millimetres and maximum material length of 6000 millimetres. Finally the 'turret' press (also known as the CNC punching press) is the smallest and cheapest press (at approximately £300,000) with a delivery time of only a couple of months. The distinguishing factor of a turret press is that it is much more than a perforating machine. For example, the turret press can cut, shear, notch, bend, and emboss. In terms of perforation, its maximum material width is 1500 millimetres and maximum material length is 6000 millimetres.

[6] In addition, A&LP manufactures and sells expanded metal (of which its current share of supply in the UK is below 10 per cent). Although RMIG made no sales of expanded metal in 2008, it could supply expanded metal to customers in the UK by importing it from its other sites in Continental Europe. However, given the current lack of overlap and the absence of competition concerns given A&LP's relatively modest share, the supply of expanded metal is not considered further in this decision.

[7] For example in terms of metal type and thickness, sheet width and length, hole size, shape and spacing.

[8] That is, standard versus tailor-made/bespoke perforated sheets.

14. The parties submitted, however, that on the supply side, most specialist perforators are able to – and indeed do – supply most types of perforated metal sheets, irrespective of the particular type of press used, the specific characteristics of the perforation required, or use of the final product. In other words, according to the parties, there is supply-side substitution across different types of perforated metal. Consequently, even relevant markets defined narrowly on the demand-side (for example, building and interior, or even ceiling tiles) contain the same actual and potential competitors (on the basis of supply-side substitution). Therefore, the conditions of competition are the same in each of these narrowly-defined demand-side markets, and it is appropriate for the OFT to aggregate them to analyse the competitive effects of the merger in the supply of perforated metal in the UK.[9]

15. In this regard, no third parties advanced any arguments suggesting that it was appropriate to segment the market by type of equipment used to perforate metal sheets (that is, that a specific machine was needed to perform a certain type of perforation). In addition, the parties provided the OFT with evidence demonstrating that the different types of press (that is all-across, turret, narrow-strip, and sectional) have substantially similar characteristics in terms of sheet width, length and thickness, hole size and speed of operation.[10]

16. However, the relevant question in considering supply-side substitution is not whether it is merely technically feasible but whether specialist perforators who currently do not supply perforated metal in a certain sector would do so in response to a small but significant and non-transitory increase in price (a SSNIP) by a hypothetical monopolist in that sector.[11] Here the views of third parties on segmenting the market by sector, application, or degree of customisation were mixed. Most customers stated that the specialist perforated metal suppliers tend to operate 'across the board', that is, suppliers operate in most sectors and switch to a large extent between sectors, and are capable of carrying out both standard and bespoke perforations. Some other third parties, however, noted that bespoke perforation requires specific manufacturing practices, lead-times, distribution arrangements, and customer relationships.

17. Nonetheless, the evidence collated by the OFT in this case demonstrates that most specialist suppliers of perforated metal in the UK (for example, the parties, APW and Robert Bion, plus a number of smaller specialist perforators) already have a noticeable (although variable) presence in all

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[9] For an application of this approach to supply-side substitution and aggregation, see the OFT's decision of 28 May 2009 relating to the completed acquisition by Stagecoach Group plc of Preston Bus Limited.

[10] See footnote 5 above.

[11] See paragraph 4.51 of the draft joint CC/OFT Merger Assessment Guidelines for details on the definition of the relevant market on the basis of supply-side substitution.

the main sectors. In addition, there is no evidence in this case of factors that would prevent suppliers from operating in different sectors (for example, that a certain press is only suitable for perforating metal for use in a certain sector). Indeed, RMIG's 2008 business plan states that [ ]. Moreover, several third parties told the OFT that most suppliers would bid for contracts outside their specialisation areas if such contracts were attractive in terms of expected profitability.

18. On this basis, the OFT considers that specialist suppliers of perforated metal in the UK have both the ability and incentive to supply in all sectors, irrespective of whether they currently specialise in a certain sector. Similar considerations apply to the supply of standard and bespoke perforated metal, and for different applications. As a result, notwithstanding the lack of demand-side substitution between sectors (which suggests narrow markets), supply-side substitution suggests that the same actual and potential competitors compete in each sector. It is therefore appropriate for the OFT to aggregate these sectors and to assess the competitive impact of the merger in the manufacture and supply of perforated metal.[12]

Geographic scope

19. The parties submitted that the relevant geographic market for the supply of all types of perforated metal is at least UK-wide, and possibly wider, given the low transport costs (in relation to the value of a typical order) and the absence of quality differences between imported and domestic perforated metal. Indeed, RMIG imports some [ ] per cent of its UK sales from its Continental plants. The OFT understands this is [ ]. However, the OFT notes that UK customers of RMIG may not even realise that they are being supplied with imported metal, so these 'imports' do not constrain UK specialist suppliers of perforated metals in the same way as would direct imports by customers themselves.

20. Several third parties, however, indicated that the time-frame for the procurement of domestic perforated metal is shorter than for imported perforated metal. This, in turn, makes domestic supplies more reliable than imports, and therefore preferred. Imports of perforated metal are also riskier because of fluctuations in currency exchange rates and in relation to the price of the raw material, as well as due to the need for additional storage and logistic arrangements. These third parties also noted that

[12] It should be noted that the discussion in this section focuses on specialist suppliers of perforated metal. As is discussed further at paragraphs 55 to 58, there are also a number of sheet metal fabricators who are not specialist perforators, but do have turret presses, and can use the perforation functionality of these presses should they wish to. These players comprise part of what the parties call the 'competitive fringe' but for the most part do not compete for specialist perforation work, and are more typically customers of the specialist suppliers than competitors. These players do not appear to have the same ability and incentive to supply perforated metal across sectors as the specialist perforators have.

imports of perforated metal from outside the UK are currently more expensive than domestic supplies given the recent currency fluctuations (that is, the relatively low value of sterling) and this – together with the additional transportation costs – limits the competitiveness of imports.

21. Given this evidence, the OFT considers, on a conservative basis, that in this case the relevant geographic frame of reference is the UK. The degree of competitive constraint exerted by imports of perforated metal on UK specialist suppliers will be considered in the competitive assessment below.

Conclusion on market definition

22. Therefore, in light of the evidence discussed above, the OFT considers that the appropriate market definition in this case to be the manufacture and supply of perforated metal in the UK.

COMPETITION ASSESSMENT

UNILATERAL EFFECTS

23. The parties argued that the transaction would raise no prospect of a substantial lessening of competition because the merged firm will be constrained post-merger by other specialist perforated metal suppliers, by other sheet metal fabricators, by imports from major foreign perforators, or by the spare capacity available in the market.

24. However, for the reasons set out below, the OFT considers that the proposed transaction raises the realistic prospect of a substantial lessening of competition on the basis of unilateral effects, that is, that after the merger the merged entity may be able to increase prices (or reduce output) unilaterally.

Market shares

25. According to the parties, post-merger they will have a combined share of [15-25] per cent (RMIG, [5-15] per cent, A&LP, [5-15] per cent). The parties estimated the remaining [75-85] per cent of the market to be fragmented: other major metal perforators having [10-20] per cent of the market (APW with [0-10] per cent, Pickering with [0-10] per cent, Robert Bion with [0-10] per cent,[13] Ingleton with [0-10] per cent, and Gooding and Graepel with [0-10] per cent each), foreign suppliers having [0-10]

[13] The OFT considers that the parties may have under-estimated the share of supply of Robert Bion, or over-estimated the share of supply of Pickering, given that the vast majority of customers contacted mentioned APW and Robert Bion as the parties' main competitors, A&LP's own internal figures suggest that Pickering is substantially smaller than Robert Bion and RMIG's internal documents reveal that it only benchmarks its position against APW, A&LP and Robert Bion.

per cent, and a UK 'competitive fringe' having the remaining [50-60] per cent of the market.

26. However, the OFT notes that the parties' estimate of their combined market share conflicts with their own internal documents. In particular, the OFT notes that RMIG's [ ] of late 2008 attributes to itself and A&LP market shares of [25-35] per cent and [35-45] per cent, respectively ([65-75] per cent combined). The parties submitted that this internal analysis of market shares was undertaken only on the basis of major competitors' turnovers and that the true size of the market was at least double this (a point corroborated by [ ]) but the OFT notes that the market shares in the document do allow for the existence of a competitive fringe (which accounts for just [5-15] per cent of the market).

27. In spite of this, the parties submitted that the share of supply attributed to the 'competitive fringe' in their internal documents nonetheless under-represents the fringe's constraint upon the parties. However, as discussed further in paragraphs 55 to 58 below, the OFT considers that this is not substantiated by the evidence currently available. In particular, many of the smaller perforators identified by the parties do not appear able to compete with the parties (in terms of order size, delivery terms, job specification, etc) or told the OFT that they do not supply perforated metal in the UK at all (see paragraph 56 below).[14]

28. Moreover, in the same document RMIG labels itself as [ ], whereas A&LP is referred to as [ ]. Indeed, the parties' combined market share and their status as the number one and two perforators in the market is also reflected in A&LP's internal documents, which estimate a combined market share of [55-65] per cent—RMIG, [25-35] per cent, A&LP, [20-30] per cent—again allowing for smaller perforators and imports.

29. The parties also presented an analysis of their 137 largest quotations for the supply of perforated metal—usually provided following a customer request on the phone—for 2007, 2008 and 2009 to date (the 60 largest customer requests for quotation from RMIG and the 77 largest from A&LP).[15] The parties' analysis indicated that RMIG won [ ] per cent (by volume) and [ ] per cent (by value) of the business that it quoted for, and

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[14] Excluding the 'competitive fringe' from these figures, the merged entity will have a combined share of [45-55] per cent. APW, Pickering and Robert Bion would have a share of [10-20] per cent, [5-15] per cent and [5-15] per cent, respectively, followed by Mevaco (a foreign importer, with [5-15] per cent) and Ingleton ([0-10] per cent).

[15] The difference in the size of the samples is because in 2008, A&LP started offering installation services bundled with perforated metal, whereas previously it had only quoted on a 'materials only' basis (as RMIG does). Where an A&LP quotation included installation, it was not possible for the parties to estimate the value of the quotation on a 'materials only' basis. So the parties analysed two samples of the 60 largest quotations for A&LP: the 60 largest quotations that the parties were sure did not include an installation element, and the 60 largest quotations overall. There were 17 quotations in the 'all quotations' data that were not also in the 'materials only' data, meaning the parties analysed 77 separate A&LP quotations in total.

that A&LP won between [ ] and [ ] per cent (by volume) and [ ] and [ ] per cent (by value) of the business that it quoted for.[16] The parties submitted that these estimates were low and were consistent with their estimated market shares derived from other sources.

30. For the three reasons discussed below, however, the OFT is only able to attach limited weight to this evidence.

- Firstly, the parties did not know what proportion of the requests for quotation that they received from customers were made in good faith and led to actual business for a competitor. If a quotation was for business that was never actually there to be won, then its inclusion in the sample deflates the apparent proportion of quotations 'won'.

- Second, the dataset used in the analysis does not appear representative. In particular, the dataset includes only 60 requests for quotation from RMIG and 77 from A&LP. In view of the fact that RMIG alone receives approximately [ ] telephone enquiries per month (that is, [ ] annually, or [ ] in the analysis period), this implies that the sample included in the analysis amounts to less than one per cent of all requests for quotation received from 2007 to date. Related to this, the value of the contracts won by the each of the parties included in the sample of 137 is only some [ ] per cent of their total combined turnover in the period under consideration.

- Third, the parties acknowledged that the data used in the analysis has intrinsic limitations. These include the fact that: (i) the range of values in the parties' 20 largest quotations for each year in the sample differ markedly, (ii) requests for quotation could be made to RMIG or A&LP at different times, (iii) the parties may record potential customers' names in different ways, and (iv) there are a number of duplicate bids in the sample.

31. Indeed, the parties themselves acknowledged that 'because of the potential limitations of the data set, the primary case against the SLC is supported by alternative forms of evidence to the bid study' (namely: spare capacity, large competitive fringe, imports, and self-supply, see the corresponding sections below).

32. Finally, given the disparity between the parties' estimated market share and the market shares attributed in the parties' internal documents, the OFT also considered the shares of capacity (that is, expressed in terms of the number of presses installed) and concluded, even on this crude

[16] Depending on the A&LP sample of quotations used (see footnote above).

metric, that the parties would have a share of [40-50] per cent (that is, [ ] presses out of a total of [ ] post-merger).[17]

33. Accordingly, given the evidence presented above, the OFT considers that the parties' combined post-merger share of the manufacture and supply of perforated metal in the UK is best characterised as being in the range of approximately 50 to 70 per cent. This combined share is of sufficient magnitude to give the OFT *prima facie* concerns over the merger giving rise to unilateral effects.

34. The remainder of this section on Unilateral Effects is devoted to considering the other arguments put forward by the parties and evidence obtained by the OFT during the course of its inquiry, and in particular whether such evidence supports or rebuts the OFT's *prima facie* concerns.

Extent of competition between the merging parties

35. The parties argued that they focus on different sectors (that is, that A&LP's focus has traditionally been on high-volume orders in the [ ] and [ ] sectors, while RMIG is a stronger player in the [ ] and [ ] sectors). Moreover, they argued that even within the same sector (for example, [ ]), they focus on different segments (that is, A&LP specialises in [ ], where RMIG has [ ]). As a result, the parties submitted that their combined market share overstates the current extent of competition between them, and therefore the loss of competition that would result from the merger.

36. Notwithstanding some apparent tension between the parties' arguments in this regard and their arguments on supply-side substitution and market definition, some third parties did indicate to the OFT that to a certain extent A&LP and RMIG tend to specialise in different sectors. However, several of them also indicated that the merging parties compete against each other to a great extent. These third parties have also indicated that APW and Robert Bion closely compete with the parties, alongside a few other (smaller) perforators, that is, Pickering and Ingleton. This is in accordance with RMIG's internal documents (namely, [ ]), where the only named competitors against which RMIG benchmarks itself are A&LP, APW and Robert Bion.[18] It is also in accordance with the sales data collated by the OFT for all the major competitors, which shows that there is a significant degree of overlap across all perforators.

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[17] The figure of [ ] presses was provided by the parties in their original submission. The presses included in this calculation include those in RMIG, A&LP, Robert Bion, APW, Pickering and Ingleton. The presses of the 'competitive fringe' have been excluded from this calculation, see paragraphs 55 to 58 below.

[18] It is also worth noting that the parties, APW and Robert Bion are the only players which own all-across presses (as opposed to the lighter and more flexible turret presses discussed below in the text).

37. The parties also presented a 'matching analysis' of a subset of the 137 largest quotations by RMIG and A&LP discussed in paragraph 29 above for which both parties appeared to have submitted quotations.[19] The parties' analysis revealed that in [ ] quotations out of [ ] matched (that is, [10-20] per cent), RMIG quoted against A&LP but did not convert any of these [ ] quotations into business. The analysis also revealed that in [ ] quotations out of [ ] matched (that is, [0-10] per cent), A&LP quoted against RMIG but converted just [ ] of these [ ] quotations into business. On this basis, the parties submitted that RMIG and A&LP compete against each other at most [ ] of the time and therefore are not close competitors.[20]

38. Again, it was hard for the OFT to attach much evidentiary weight to this 'matching analysis'. In addition to the limitations of the quotations data discussed in paragraph 30 above, the parties did not know how often a potential customer requested a quotation from either RMIG or A&LP when the other was the customer's incumbent supplier. Instead the parties' 'matched' data only revealed when a potential customer (who presumably was either new to the market or was a customer of APW, Robert Bion, Pickering, Ingleton etc.) requested a quotation from both of them. Given that RMIG and A&LP appear to be the incumbent suppliers to between 50 and 70 per cent of customers (based upon their estimated market shares), it is unsurprising that the proportion of requests for quotation that they both receive from customers is low.

39. Accordingly, the OFT considers that the parties, together with APW and Robert Bion, compete for the majority of contracts relating to the manufacture and supply of perforated metal in the UK, and that there is no evidence that the parties' estimated market shares overstate their position in the market.

A&LP's strength as a competitor

40. The parties argued that:

- A&LP's sales have been [ ] since 2006
- it has undergone [ ] exercises,[21] and
- A&LP needs [ ].

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[19] The size of the subset of 'matched' quotations analysed varied between [ ], [ ], [ ], [ ], [ ] and [ ], depending on how the data was cut.

[20] The parties' conclusions from the 'matching analysis' appeared qualitatively robust to correcting for various deficiencies in the quotations data.

[21] [ ] involved the closure of A&LP's site in Hayle (which A&LP had previously acquired in 2001) in November 2007, and the subsequent consolidation of all A&LP's activities at its current factory of Smethwick (Warley), in the West Midlands.

Accordingly, the parties argued that A&LP's share in 2008 may overstate its position in the market in the future.

41. Whilst the OFT acknowledges that A&LP's sales have been declining over time (2007: £11.2 million, 2008: £10.1 million, 2009 (expected): £[ ]), the OFT notes that after the [ ] A&LP is expecting to achieve an operating profit of £[ ] in 2009, compared to losses of £[ ] and £[ ] in 2007 and 2008, respectively. Accordingly (and contrary to the parties' submission), the OFT considers that this gradual progress towards positive operating profits indicates that A&LP could well be a strong competitor in the future.

42. The OFT notes that this is corroborated by RMIG's 2008 business plan, where it is acknowledged that, [ ], it had managed to retain its key existing customers and was developing their construction products. Accordingly, the OFT does not consider that this is sufficient evidence that A&LP would not continue to be a strong competitor going forward.

Excess capacity

43. In markets where the products are relatively undifferentiated, such as the supply of perforated metal under consideration in this case, the extent of capacity constraints amongst rivals can have an important impact on the ability and incentive of the merged entity to raise prices by reducing output. If rivals have spare capacity, they will find it optimal to increase their output in the face of an attempted price increase, and thereby dampen the price rise. The precise degree to which this happens depends on the extent of rivals' spare capacity relative to the incremental market share gained by the merged firm. If rivals are working at full (or near full) capacity, then little dampening may be possible. Conversely, if rivals have substantial spare capacity, then more dampening may be possible.[22]

44. In this case, the OFT notes that the current economic downturn has caused, at least for the time being, a reduction of activity in the construction sector, as well as in other sectors where perforated metal is used. The corollary effect of this decrease in demand is that a significant amount of spare capacity is available for the manufacture of perforated metal. Indeed, the parties estimated that there was at least 40 to 50 per cent spare capacity in the industry and that accordingly there was sufficient excess capacity to serve the entire market.

45. Some of the parties' rivals in the UK confirmed that there was approximately 40 per cent spare capacity in the market. However, whilst high levels of spare capacity would, in some circumstances, be sufficient to allay the *prima facie* competition concerns identified in the previous sections, the parties' rivals confirmed that the current levels of spare

[22] See paragraph 4.016 of the draft joint CC/OFT Merger Assessment Guidelines.

capacity in the market are not structural but purely a temporary glut due to the economic downturn. In particular, several third parties confirmed that they were running with little (or no) spare capacity from 2007 until early 2008 (that is, immediately before the reduction in demand was felt).[23]

46. Furthermore, it is worth noting that after the merger, in the absence of capacity expansion plans (of which the OFT has received no firm evidence, see below), the merging parties would control approximately the same amount of spare capacity (looking at the number of presses installed) as all their main rivals (that is, APW, Robert Bion, Pickering and Ingleton) combined. The fact that independent spare capacity is spread across several smaller rivals makes it likely that at least some of them will be capacity-constrained once the demand for perforated metal picks up again. Indeed, this was the case for some of the parties' rivals until recently. This, in turn, would make it more difficult for the parties' rivals to defeat any attempt by the merging parties to increase prices.

47. Accordingly, in light of the evidence discussed above, the OFT considers that the amount of excess capacity that will exist in this sector, once the demand for perforated metal picks up again, may not be sufficient to allay the competition concerns discussed above. Given the current decline in demand is cyclical (rather than structural) the OFT considers that it is reasonable to assume, and take account, of the inevitable rebound in demand in the short-term.

48. In the light of this information on spare capacity, the OFT has sought to combine the evidence available to it on the parties' market share and their gross profit margins to provide a simple, illustrative gauge of the possible upward pressure on prices arising from the merger.[24] Under the assumption that there is no spare capacity in the market, the upward pressure on pricing potentially arising from the merger would be around

[23] Cf. the OFT's assessment in *Celsa/BRC/Express Reinforcements/ROM*, where the OFT found evidence of significant long-term amounts of independent spare capacity in the fabrication of steel reinforcement products (see paragraph 55 in: www.oft.gov.uk/shared_oft/mergers_ea02/2009/Celsa.pdf). The OFT also found evidence of a constraint from imports in that case.

[24] For an application of the OFT's approach, see footnote 3 of the OFT's decision of 6 May 2009 relating to the anticipated acquisition by Prince Minerals Limited of Castle Colours Limited, and Appendix A of the 'Review of merger decisions under the Enterprise Act 2002', of 18 March 2009 (www.competition-commission.org.uk/our_role/analysis/review_merger_decisions.pdf). The model used by the OFT to calculate the upward pressure on prices assumes that firms compete *à la* Cournot in the marketplace (that is, products are not differentiated in terms of branding and/or quality, and firms' production capacity is decided in advance and cannot be easily or quickly adjusted) – an assumption which the parties agreed is appropriate in this case. The model also assumes linear demand and constant marginal costs (that may differ between firms).

[15-25] per cent.[25] Under the assumption that there is spare capacity in the market, as the parties submit, the upward pressure on pricing potentially arising from the merger depends on the number of competitors in the market but appears to be at least [5-15] per cent (assuming APW, Robert Bion, Pickering and Ingleton are the parties' only competitors—for more on this, see below).[26]

Demand for perforated metal

49. The parties initially argued that in addition to excess capacity, the demand for perforated metal in Europe has been declining by approximately 2 per cent per year over the last five years.

50. In fact, a closer look at the data revealed a different picture. In particular, the parties themselves calculated the following year-on-year growth rates of the demand for perforated metal (expressed in volume terms, and after adjusting for increasing raw material costs): 1.3 per cent (2005), 10.0 per cent (2006), -0.6 per cent (2007), and -8.5 percent (2008). This implies a *positive* average annual growth rate of 0.3 per cent. Accordingly, (based on this data at least) it cannot be said that demand for perforated metal is necessarily experiencing a long-term decline. Accordingly, it is more accurate to say that demand for perforated metal is cyclical and has been overall stable over the period 2004 to 2008.[27] This is also confirmed by RMIG's internal documents. In particular, in [ ], RMIG mentioned that 'the UK market has been strong for a number of years'.

51. In light of the above, the OFT considers that demand for perforated metal although cyclical, has (overall) been stable.

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[25] Under the assumptions above and where the parties' competitors are capacity constrained, the upward pressure on prices (denoted by Dp/p) is calculated by dividing the smaller merging party's price-cost margin (Mx) by 2, that is, Dp/p = Mx / 2. In this case, the parties' internal evidence indicates that Mx ranges between [ ] per cent and [ ] per cent giving an estimate of the upward pressure on prices of at least Dp/p = [ ] = [15-25] per cent.

[26] Under the assumptions above and where the parties' competitors are not capacity constrained, Dp/p = Mx / N where N is the number of firms in the market (6, in this scenario): here Dp/p = [ ] = [5-15] per cent. The critical proportion of spare capacity that needs to be held by rivals in order for them not to be capacity constrained (under the assumptions above) can be written as (Sx/Sr).[(N-2)/N] where Sx is the smaller merging party's market share and Sr is the aggregate market share of the parties' rivals. In this case, Sx = [ ] per cent, Sr = [ ] per cent and N = 6. Accordingly, APW, Robert Bion, Ingleton and Pickering would need to hold between [45 to 65] per cent of spare capacity in order for them not to be constrained. Given the evidence discussed above, it is not clear that this is the case. Even increasing the number of firms to 8 (that is, including Graepel and Gooding), the extent of upward pressure of prices would be substantial, that is, Dp/p = [ ] = [0-10] per cent. In this case, the share of spare capacity that the parties' rivals would need to hold in order not to be constrained would be between [50 and 70] per cent.

[27] Cf. the OFT's assessment in *Prince/Castle* on the evolution of demand for bricks and tiles (at paragraph 63: www.oft.gov.uk/shared_oft/mergers_ea02/2009/Prince_Minerals.pdf).

Competitive constraint exerted by other UK metal perforators

52. The parties submitted that although they may be the largest metal perforators in the UK, there are other major players that is, APW and Robert Bion, and other smaller perforators (for example, Ingleton and Pickering). The parties also argued that the fact that each of these smaller perforators owns approximately the same number of presses as RMIG confirms that they are capable to exert a competitive constraint on the parties.

53. Third parties consulted by the OFT in this case indicated that the major players, APW and Robert Bion, compete with each of the merging parties to a great extent. For example, a manufacturer of cabinet enclosures recently chose Robert Bion as co-supplier alongside A&LP. However, in relation to the smaller players (such as, Ingleton and Pickering) third parties did not consider that they were able to constrain the merging parties.

54. As noted above, however, the individual market shares of the major players and the smaller perforators are much smaller than the parties' combined share after the merger (in terms of sales—with the next largest competitor have just [10-20] per cent to the parties' combined share of [45-55]-plus per cent—and in terms of number of presses installed).[28] As a result, while the OFT acknowledges that these firms compete for the supply of perforated metal in the UK and to some extent constrain the merging parties, it considers that the strength of these UK rivals is not sufficient to allay the competition concerns identified above.

Competitive constraint exerted by the 'competitive fringe'

55. The parties submitted that in addition to competition from other perforation firms (discussed above) they also face competition from sheet-metal fabricators offering perforation services. In line with the parties' submission, we refer to these players as the 'competitive fringe'. In particular, according to the parties, this fringe of smaller competitors has typically invested in turret-press technology, which is the most flexible and cheapest equipment currently available to perforate metal. In this respect, the parties provided a list obtained from information available in the public domain of 53 firms that had some CNC[29] punching (perforating) capability and some examples of where contracts were lost to some of these players.

56. In the time available, the OFT was able to contact 37 of these 53 named firms. Only three of the firms contacted stated that they ordinarily supply perforated metal to third parties. The rest indicated that, given the

[28] See paragraph 32 above.
[29] CNC is the acronym for Computer Numerical Control.

flexibility and ease of operation of these machines, they use their CNC presses for a variety of tasks (which may or may not include perforation) in the process of arriving at a fully finished metal product. Accordingly, the large majority of these CNC punching firms contacted by the OFT indicated that they seldom receive requests to supply perforated metal. Moreover, should they need large volumes of perforated metal, several of these CNC punching firms would consider (or indeed already do) source from the parties, or their main rivals, rather than carrying out large-scale perforation in-house. Accordingly, most of these CNC punching firms regarded themselves as (actual or potential) *customers* of the parties, rather than competitors.[30]

57. As a result, the OFT is not able to conclude that this competitive fringe is as large as is claimed by the parties or would be capable of providing a strong competitive constraint on the parties post-merger.[31] In addition, none of the third parties consulted by the OFT mentioned such a competitive fringe in their responses. Moreover, as noted above, in its 2008 business plan RMIG only mentions (and benchmarks its position against) APW, A&LP and Robert Bion. Therefore, save for in one small footnote, this competitive fringe does not appear in any of the internal evidence provided by the parties (the list of 53 firms mentioned at paragraph 55 above was prepared for the purposes of this merger review).

58. Accordingly, in light of the evidence discussed above, even if there are a small number of these sheet metal fabricators that could supply third parties with small volumes of perforated metal, the OFT does not consider that these are large enough, in combined capacity or number, to form an effective competitive fringe capable of constraining the parties post-merger.

Competitive constraint exerted by foreign suppliers

59. The parties submitted that a number of firms located in Continental Europe, Asia and the United States export perforated metal into the UK and exert a competitive constraint on UK producers. In particular, the

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[30] It is also worth noting that most of the 53 CNC punching firms included in the parties' list only have one press installed at their sites. As a result, even if these firms were to start supplying perforated metal on the market, they would be unlikely, given their size and need to work round their own internal demand, to be able to satisfy medium to large orders, or meet customers' requirements in terms of delivery timing. Therefore, the OFT's estimate of the upward pressure on prices potentially arising from the merger if all rivals were capacity constrained, of [15-25] per cent, would be unaffected by the existence of these extra capacity-constrained firms.

[31] Put differently, if these three firms (in addition to the 8 discussed in footnote 26 above were effective competitors to the parties and had sufficient spare capacity to expand, the OFT's estimate of the upward pressure on prices potentially arising from the merger would still be approximately [0-10] per cent (that is, Dp/p = [ ] = [0-10]).

parties cited a number of contracts that the parties lost to these foreign rivals, including tailor-made contracts.

60. The OFT considers that while some UK customers do buy perforated metal from foreign suppliers, it appears unlikely that the latter exert a strong competitive constraint on UK producers. Firstly, several customers indicated that they frequently request deliveries of perforated metal (especially tailor-made) according to a short-time frame ('just in time' of three to four days), and that foreign suppliers are not able to meet these requirements. Moreover, according to the same third parties, imports from abroad also raise some transportation logistic issues (for example, additional need for storage).

61. In addition, even if imports of perforated metal into the UK have increased from [0-10] per cent of total in 2003 to around [5-15] per cent in 2008 (as the parties claim),[32] these volumes are still relatively small and conversely confirm the slow entry of foreign suppliers into the UK market. Moreover, the foreign supplier with the largest presence in the UK (Mevaco) realises the bulk of its sales by supplying standard sheets, and not tailor-made sheets which represent the majority of UK demand. Finally, the recent currency fluctuations have made imports of perforated metal from Continental Europe more expensive, which further undermines their competitiveness.

62. The OFT considers that the fact that foreign suppliers represent a weak competitive constraint can be distinguished from the fact that [ ] per cent of RMIG's sales into the UK are imported from its factories in [ ] and [ ]. This is due to the fact that RMIG is uniquely well-placed, with a local presence in the UK, to facilitate such imports in many respects (for example, procurement, marketing, and distribution).

63. In this respect, the OFT also notes RMIG's concerns regarding its non-UK imports: In particular, in [ ], possibly indicating that its deliveries from Continental Europe are riskier than local (that is, UK) supplies. The OFT is also aware that at least one customer declined to award a contract to RMIG because RMIG intended to procure the perforated metal from one of its factories outside the UK.

64. As a result, despite the parties citing a few examples where foreign rivals have imported perforated metal in the UK, given the overwhelming responses from third parties, the OFT considers that these foreign firms and limited contract occurrences are unlikely to constrain the merging parties and/or other UK perforators after the merger is completed.

[32] In fact, in their information on shares of supply the parties attribute to foreign suppliers a cumulative share of around [0-10] per cent.

Self-supply

65. According to the parties, current buyers of perforated metal could defeat any attempt to increase price post-merger by vertically integrating upstream (that is, by bringing metal perforation in-house and self-supplying), or threatening to do so. They argued that this would be especially true for some sectors, that is, automotive and transport and communication and cited several examples where customers switched to self-supply.

66. In relation to the examples of previous customers that switched to self-supply, the OFT contacted these companies, who confirmed that the rationale for bringing perforation in-house was to reduce costs and to gain more flexibility. However, the parties were only able to provide a few limited examples of customers switching to self supply, and the OFT notes that, in those examples, the switch had occurred approximately 10 years ago, indicating that customers do not frequently, or even regularly, switch to self supply.

67. In fact, several buyers of perforated metal consulted by the OFT during the investigation stated that, given the volumes they require and their particular specifications, self-supply was not a feasible option. By way of example, the OFT considers it noteworthy that after the closure of the Hayle site by A&LP, one of the largest purchasers of perforated metal in the UK brought in-house the finishing work only, while transferring some of the orders for perforated metal to other perforators.

68. As a result, in light of the above, the OFT does not consider that self-supply would exert a sufficient competitive constraint on the merged entity after the merger.

Barriers to entry and expansion

69. New entry, the threat of new entry, and expansion by existing suppliers, can all represent important countervailing factors, constraining the competitive behaviour of the merged entity, post-merger.

70. The parties submitted that, while entry of new players is unlikely given the current amount of spare capacity in the sector, current players (including small UK perforators and foreign suppliers) could easily expand capacity in response to a price increase. Moreover, according to the parties, customers are not generally tied to long-term contracts and could easily switch away from their current supplier.

71. Whilst the OFT notes the parties' comments above, it also is mindful of the fact that, to outweigh substantial harm arising from the merger, any entry or expansion must be timely, likely and sufficient to restore the loss

of competition arising from the merger.[33] In this particular case, given the considerations expressed above in respect of excess capacity and the strength of the parties as competitors at a national level, the scale of any such entry or expansion in this case would need to be substantial in order to offset the impact of this merger.

72. We now examine entry by UK and/or foreign suppliers and expansion by competitors in turn.

Entry by UK and/or foreign suppliers

73. The parties argued that barriers to entry are low, in that a turret press involves a relatively modest investment of £300,000. However, they also submitted that, given the amount of excess capacity in the market, large-scale entry would be unlikely either within the UK or by foreign suppliers. This is consistent with the OFT's findings in this case.

74. The OFT also considered whether entry would be likely to occur once excess capacity had been removed from the market. However, the OFT did not find evidence either that any of the sheet-metal fabricators and other CNC punching firms indicated by the parties or importers have plans to enter the market for the supply of perforated metal in the UK and/or expand the scale and range of their activities. Finally, the OFT is not aware of any internal documents from the parties suggesting that they were concerned or had identified potential entry from other players.

75. Accordingly, in light of the lack of evidence and adopting a cautious approach, the OFT does not consider that *de novo* entry would be likely (yet alone sufficient or timely) to defeat any attempt by the merging parties to increase prices post-merger.

Expansion by competitors

76. In relation to expansion by smaller specialists of perforated metal, the parties submitted that at least one of the other specialist perforators had plans to expand capacity. This was supported by some of the parties' main rivals who told the OFT that they had been considering plans to expand capacity, which may include the addition of new capacity (for example, installation of a new perforation machine). These plans, however, had been put on hold since the start of the current economic downturn.

77. As a result, given the uncertainty surrounding these expansion plans, the OFT was unable to assess whether such additional capacity would be sufficient and timely to defeat any attempt by the merging parties to increase prices after the merger.

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[33] See Merger Guidelines '*Substantive assessment guidance*' (OFT516), paragraphs 4.17-4.26 and paragraph 4.174 of the draft joint CC/OFT Merger Assessment Guidelines.

Ease of switching

78. As for switching, the picture is more complicated than the one depicted by the parties. Several third parties did inform us that it is easy for customers to switch specialist suppliers of perforated metal, and this is done relatively frequently in response to changes in the cost of raw materials and service quality and depending on specific requirements for the job.

79. Other third parties, however, told us that it is more difficult as customers tend to develop long-term relationships with specialist suppliers. In some cases, these relationships involve the joint development of specialised equipment (for example, tooling), in which case switching becomes more difficult. For example, some customers told us that they rely on a single specialist supplier for their requirements (in which case, however, the merger would have limited or no impact on them).

80. As a result, while there is a certain degree of switching in this sector, it cannot be said that all customers could easily switch specialist suppliers of perforated metal following a price increase.

Buyer power

81. Although there is a huge variation in size, many of the buyers of perforated metal are small. As a result, the OFT considers it unlikely that they will have buyer power vis-à-vis specialist suppliers of perforated metal, and the parties have not provided evidence in this respect.

82. A few third parties, however, told the OFT that they are being offered better commercial terms than in the past (and even price reductions), as specialist suppliers are particularly keen to retain their customers during the current period of relatively low activity. The OFT, however, considers that this relative shift of bargaining power from specialist suppliers to customers may be temporary (that is, it may not survive the current economic downturn), it may only benefit selected buyers of perforated metal (that is, larger customers, but not smaller ones), and therefore it is insufficient to allay the competition concerns identified above.

Conclusion on unilateral effects

83. The OFT considers that the weight of the above analysis indicates that the proposed transaction gives rise to competition concerns on the basis of unilateral effects. In particular, the parties are the two largest metal perforators in the UK with high market shares.

84. Furthermore, the OFT considers that the scale of entry or expansion in this case would need to be substantial in order to offset the scale of the parties and the potential upwards pressure on prices arising from the merger. In light of the above, the OFT is not persuaded that the timeliness

of scale of any entry and/or expansion would offset any consumer harm sufficiently quickly.

85. In addition, the OFT does not consider that the competitive constraint exerted by metal-sheet fabricators and/or foreign suppliers is sufficient to allay competition concerns. Lastly, the OFT is not convinced that the amount of excess capacity currently available in the industry will survive the economic downturn and will be sufficient to prevent the parties from rising prices or reducing output.

COORDINATED EFFECTS

86. As the proposed concentration reduces the number of the major specialist suppliers of perforated metal in the UK, the OFT considers it appropriate to assess whether the merger also gives rise to a realistic prospect of a substantial lessening of competition based on coordinated effects, that is, whether after the merger the merging parties might engage in (tacit or explicit) collusion with other suppliers.

87. In particular, the OFT notes that certain conditions possibly leading to coordination exist in this case, for example, small number of firms, a high degree of product homogeneity, availability of spare capacity which might be used to punish firms who defect from coordination, and limited possibility for non-coordinating firms (as well as potential competitors or customers) to disrupt coordination.

88. The OFT is, however, satisfied that coordinated effects would not be expected to arise in this case. In particular, factors which impede coordination include the fragmentation of the customer base and the lack of transparency in the industry (which makes it difficult for coordinating firms to reach and monitor terms of coordination in this case)—as evidenced, for example, by the limitations in the parties' own 'matching analysis' of quotations discussed above—and the increase in asymmetry brought about by the proposed transaction.

VERTICAL ISSUES

89. No vertical issues arise in the context of this merger.

THIRD PARTY VIEWS

90. Comments from third party customers and competitors have been addressed where appropriate throughout this decision.

ASSESSMENT

91. The parties are the two largest metal perforators in the UK. The OFT considers that, as a result of the merger, there is a realistic prospect of a substantial lessening of competition at the national level in relation to the manufacture and supply of perforated metal.

92. The OFT considers that the parties' combined share is of magnitude to result in *prima facie* concerns over the merger giving rise to unilateral effects.

93. In relation to the arguments put forward by the parties regarding significant excess capacity for perforated metal, the OFT considers that the current level of excess capacity in the market is temporal (as opposed to structural) and is unlikely to be available once the economic climate has improved.

94. In relation to the large 'competitive fringe' of rivals referred to by the parties, the OFT does not believe that most of these very small sheet metal fabricators should be considered as competitors to the parties, not least given that they tend to regard themselves as customers, rather than competitors of the merging parties. In addition, although it appears that there are a number of smaller UK specialist metal perforators competing against the parties, the OFT has been unable to conclude that the strength of these UK rivals would be sufficient to constrain the parties post-merger. Similarly, the OFT considers that due to lead times and logistical issues, foreign suppliers are also unlikely to be able to constraint the parties post-merger. Overall, the OFT did not receive sufficient evidence to conclude that entry or expansion, would be sufficient in scale, timely and likely to offset any consumer harm that may arise as a result of the merger.

95. Therefore, assessed against the appropriate counterfactual of the prevailing pre-merger conditions of competition, the OFT believes 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 – that is, in relation to the manufacture and supply of perforated metal in the UK.

UNDERTAKINGS IN LIEU

96. The parties made no offer any undertakings in lieu of reference to the Competition Commission.

DECISION

97. The OFT has therefore **decided to refer** the anticipated acquisition by RMIG of A&LP to the Competition Commission pursuant to section 33 of the Act.