
Completed acquisition by Wolseley UK Limited of Encon Limited.

The OFT's Decision on reference under section 22 given on 27 January 2006.
Full text published 15 February 2006.

N.B. Data in square brackets has been ranged or excised for reasons of commercial confidentiality.

PARTIES

1. **Wolseley UK Limited** (Wolseley) is active in the distribution of building products in the UK where it operates a sales network of some 1,570 branches of general builders' merchants. It is part of the Wolseley group of companies (Wolseley Group) which operates worldwide in the distribution of heating, plumbing and building products.
2. **Encon Limited** (Encon) is a specialist distributor (operating 22 branches across the UK) of building products: principally insulation products, fire protection products and dry lining materials (plasterboard etc) as well as a wide range of ancillary products. Encon's turnover for the year ending 31 August 2005 was £169m.

TRANSACTION

3. Wolseley acquired the entire issued share capital of Encon on 22 October 2005. The administrative target is 27 January 2006 and the statutory deadline expires on 21 February 2006.

JURISDICTION

4. As a result of this transaction Wolseley and Encon have ceased to be distinct. Encon's UK turnover exceeds £70 million, consequently the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

BACKGROUND

5. The OFT has previously considered a number of merger transactions that are relevant to the product market in the present case. The most recent of these, SIG/Orion,¹ provides useful points of reference as to the relevant market and the nature of competition between the suppliers. In addition, at the time of writing, the European Commission (the Commission) had recently cleared the acquisition by Compagnie de Saint-Gobain of BPB plc.² In that case, the Commission examined the parties' horizontal overlaps in the distribution of insulation and plaster-based products, although the analysis focused mainly on vertical issues.

RELEVANT MARKET

Product market

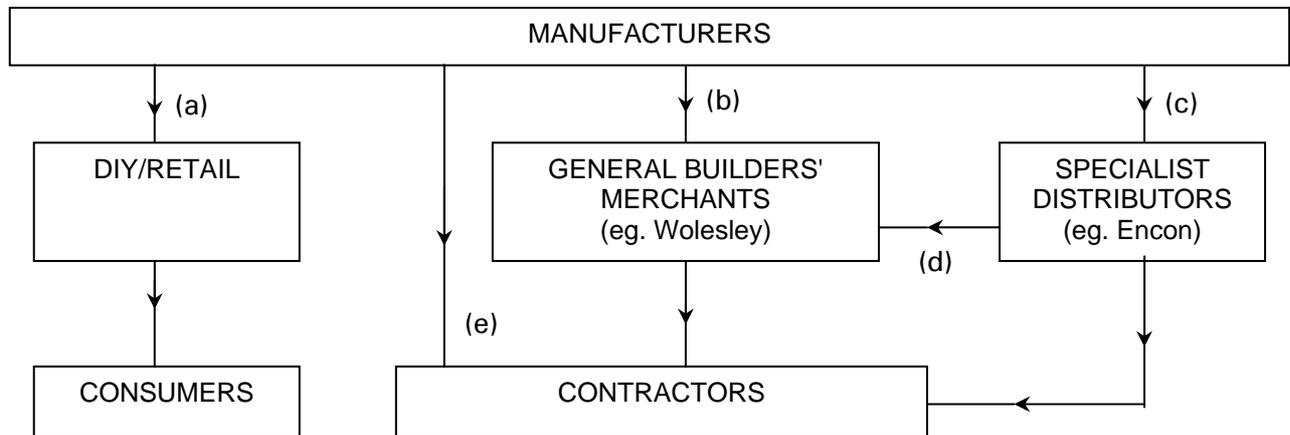
6. The parties overlap in the following areas of commercial activity:

Area of overlap	Description
Distribution of structural insulation products	Products used in lofts, walls, floors, roofing and other parts of the fabric of all types of buildings to contain heat and sound.
Distribution of industrial insulation products	Insulation materials applied to pipes, vessels, tanks, process plants, heating and ventilation, power generation and oil installation.
Distribution of structural fire protection products	Boards and fibrous products incorporated into buildings to resist fire damage. (Does not include sprinkler and foam systems).
Distribution of dry lining materials	Plasterboard and related materials.
Distribution of plaster	Bagged gypsum-based powder which is mixed with water into paste and applied to hard surfaces as a finishing.
Distribution of ancillary and related products	Wooden batons, tools, fixing tape, adhesives etc. The parties submit that these are part of the wider UK construction market as they have wider applications outside the areas where the parties overlap.

¹ ME/1282/04 - Completed acquisition by SIG plc of Orion Trent Holdings Ltd - October 2004.

Industry structure

7. The diagram below illustrates the various channels of supply of building products - including the building products distributed by the merging parties - from the manufacturers, via the distributors where applicable, to the end users.



8. The principal wholesalers and purchasers of these products are:
- a. DIY retailers who distribute building products for sale to consumers. Since this is not an area of overlap between the merging parties, no further consideration of the DIY/Retail channel in the context of this analysis.
 - b. General builders' merchants (e.g. Wolesley) who make wholesale purchases of an entire range of building products from the manufacturers for distribution to professional building contractors.
 - c. Specialist distributors (e.g. Encon) who focus on the procurement from one or more manufacturers of specific segments of building product (such as 'dry lining materials' and 'below ground construction') for distribution to professional building contractors.
 - d. General builders' merchants who make purchases from specialist distributors in the event that they are unable to source a particular product directly from the manufacturers. On average, around 20 per cent of the total purchases made by builders' merchants are from specialist distributors rather than directly from the manufacturers.

² COMP/M.3943 - Saint Gobain/BPB - 09/11/05.

- e. Contractors who have the facilities to procure building products directly from the manufacturers and store in sufficient quantities (as might be the case where a major housing development or construction project is concerned). However, most manufacturers sell no more than 10 per cent of their total output direct to contractors.
9. The relatively small amount of direct selling by manufacturers to contractors may only represent a limited competitive constraint on the distributors of the relevant products. Third party comment indicates, however, that there is competition between builders' merchants and specialist retailers.
 10. The main focus of the analysis in this paper is therefore on the impact of the loss of competition between Wolseley and Econ in the distribution of the building products listed in paragraph 6 (the relevant products).

Geographic market

11. The parties submit - and third parties agree - that the geographic scope for the sale of the relevant products is the UK.
12. There is little evidence to suggest that the geographic scope is any wider than national. The parties note that in the UK import penetration is low due mainly to the fact that the products in questions are for the most part bulky and costly to transport.
13. Most distributors of the relevant products deliver within a radius of approximately 30 to 40 miles - although some third party competitors propose that delivery radii vary considerably. Transport costs over these distances represent a proportion of [x per cent to y per cent] of total costs.
14. The parties' distribution activities overlap in 16 local areas. Due regard will therefore also be had to the impact of the merger at a local level.

HORIZONTAL ISSUES

Market shares

Distribution of structural insulation products

15. The parties submitted that their combined share of the supply of structural insulation by value is [5 per cent - 15 per cent] (increment [0 per cent - 5 per cent]). This is based upon a total structural insulation market value of £832.6m in 2004.³
16. According to competitors, Wolseley and Encon did not compete closely pre-merger. These respondents submitted that Encon is considered to be a specialist selling a wide range of products, whilst Wolseley acts as a builders' merchant, selling a more basic range of products. One competitor also suggested that Wolseley was not a significant competitor in insulation through its Build Center network. One customer suggested that Encon and Wolseley did compete closely pre-merger, but noted that a number of alternatives existed. All customers and competitors suggested that a number of competitors will remain post-merger, including SIG, Travis Perkins (CCF) and Minster, in addition to a large number of regional competitors. Switching costs were considered to be low. Manufacturers supported this view, and also suggested that the increment resulting from the transaction was too small to lead to competition concerns.

Distribution of industrial insulation products

17. The overlap in the distribution of insulation for industrial applications is limited. Post-merger, the parties' combined share of supply is [5 per cent - 15 per cent] (increment [0 per cent - 5 per cent]) by value. A significant number of alternative suppliers remain and there has been no adverse comment from third parties. The OFT therefore considers that the merger raises no competition concerns in this area of overlap.

Distribution of fire protection products

18. The parties submitted that their combined share of the distribution of structural fire protection products in the UK will be [5 per cent - 15 per cent] by value post-merger (increment [0 per cent - 5 per cent]). SIG and FGF compete in this sector and there are a numerous smaller outlets supplying fire protection products. No third parties have raised concerns. The OFT therefore considers that the merger raises no competition concerns in this area of overlap.

Distribution of dry lining materials

19. The merged entity has a combined share of [5 per cent-15 per cent] by value of the supply of dry lining post-merger (increment [0 per cent - 5 per cent]). SIG and CCF also compete in this sector. Evidence from *SIG/Orion* suggests that materials are generic and can be obtained from a considerable number of alternative sources. No third parties have raised concerns. The OFT therefore considers that the merger raises no competition concerns in this area of overlap.

Distribution of plaster

20. The merged entity has a combined share of supply of bagged plaster (by value) of [5 per cent - 15 per cent] (increment [0 per cent - 5 per cent]). A number of alternative suppliers are active in this sector. No third parties have raised concerns. The OFT therefore considers that the merger raises no competition concerns in this area of overlap.

Distribution of ancillary and related products

21. The parties submitted that their combined share of supply of ancillary products is [5 per cent - 15 per cent] (increment [0 per cent - 5 per cent]) by value. It appears that ancillary products are widely available from a wide range of outlets, including builders' merchants and DIY stores. No third parties have raised concerns. The OFT therefore considers that the merger raises no competition concerns in this area of overlap.

Local issues

22. Encon's network of 22 specialist distribution branches covers the UK, whilst Wolseley operates 261 'Build Center' branches, which are also located across the UK. The parties overlap in 16 localities. Details of competing specialist distributors, builders' merchants and DIY stores have been provided by the parties. Based on a narrow delivery radius of 20 miles, there are a large number of competing fascias in each overlap area. A number of builders' merchants (range 14 - 109 fascias) and specialist distributors (range 0 - 8 fascias) are present in each area.⁴ No third parties have raised concerns about local overlaps. Some customers have suggested that a number of regional distributors are present (one customer named Passmore's and Essex as alternatives). As a result, the OFT does not consider that the transaction leads to competition concerns at a local level.

³ MBD The thermal insulation market development 2005.

⁴ Note that there is no increment in specialist distribution and 24 builders' merchant fascias remain in Newmarket (the area with no independent specialist distributors).

Barriers to entry and expansion

23. The parties submitted that in all the sectors under consideration, entry barriers are not insurmountable. Technical barriers are considered low and entry is possible on a small scale, although some knowledge of the industry would be required. The costs involved depend on the scale of the intended operation and the extent to which existing distribution outlets can be used. A new entrant with no existing outlets would need to invest in suitable premises, staff, delivery vehicles and stock. The initial stock investment would be in the region of [£xxx,xxx] - [£xxx,xxx]. Premises would probably be leased and suitable staff with appropriate knowledge would have to be recruited. An existing distributor wishing to add insulation to its portfolio would have to invest in stock and recruit staff with insulation knowledge.
24. Encon submitted that its own experience of opening new branches has shown that a good return and reasonable operating profit can be achieved within [x] years of opening a new branch. However, large-scale new entry has been limited over the past five years. Apart from small, local distributors, Minster Insulation (part of Jewson) has been the only significant new entrant.
25. Third parties have suggested that new entry is not straightforward, pointing to a shortage of skilled labour and problems with obtaining credit and competitive prices from a supplier (partly due to quantity discounts). Entry costs, however, were not considered to be prohibitive. Expansion to a regional or national level would not be easy, however.
26. In summary, it appears that entry on a local level is feasible. However, expansion to a regional or national level is more difficult.

Buyer power

27. Customers are generally able to switch between a number of alternative sources of supply. Larger customers are often able to obtain volume discounts. Some smaller merchants participate in buying consortia in order to obtain discounts. It is therefore considered that some degree of countervailing buyer power exists. In the absence of any competition concerns there is no need to quantify how strong that power is.

VERTICAL ISSUES

28. Specialist distributors such as Encon occasionally supply building products to builders' merchants such as Wolseley. The merger therefore, albeit to a limited extent, may potentially encompass some degree of vertical integration. However,

the industry overall is fragmented and a large number of alternative suppliers remains post merger. No competing builders' merchants have raised concerns over potential vertical issues.

THIRD PARTY VIEWS

29. The principal five competitors of the parties and each of their respective five principal customers of each party were contacted. Three manufacturers were also contacted. All respondents were unconcerned. The response rate from customers was limited.

ASSESSMENT

30. The parties overlap in the distribution of a number of building products: insulation, fire protection, dry lining and ancillary products. Each sector has been considered separately, consistent with previous OFT decisions.⁵ Encon acts as a specialist distributor, whilst Wolseley is a general builders' merchant.
31. The combined share of supply and increment resulting from the transaction is low in each sector on any measure. Specialist distributors appear to compete with builders' merchants, although third parties have stated that the parties did not compete closely pre-merger. In addition, a number of strong competitors will remain post-merger. Manufacturers also compete for distribution contracts, although to a more limited extent.
32. The OFT does not consider barriers to entry to be prohibitive. Due to lack of market power, vertical issues do not raise competition concerns. No adverse comments were received from third parties.
33. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

34. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.

⁵ Including SIG/Orion.