

## Anticipated acquisition by Wavin B.V. of Hepworth Building Products (Holdings) Limited

The OFT's decision on reference under section 33 given on 4 February 2005

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Please note square brackets indicate figures replaced by a range at the parties' request.

### PARTIES

1. **Wavin B.V. ('Wavin')** is an undertaking incorporated in the Netherlands which manufactures and supplies plastic pipes and fittings. **Hepworth Building Products (Holdings) Limited ('HBP')** is a subsidiary of Hepworth plc, which in turn is owned by Vaillant GmbH ('Vaillant'), a German undertaking. HBP manufactures and supplies pipes and fittings made out of clay, concrete and plastic. HBP's UK turnover for the financial year ending 31 December 2003 was [more than £70 million].

### TRANSACTION

2. Wavin proposes to acquire HPB, its subsidiaries and some other companies from Vaillant. Of the operations being acquired, only HBP trades in the UK. The parties submitted a merger notice on 28 October 2004. This was withdrawn on 12 November 2004 and the notification thereafter treated as an informal notification.

### JURISDICTION

3. As a result of this transaction Wavin and HPB will cease to be distinct. The UK turnover of HPB exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. It is therefore 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.

## RELEVANT MARKET

### Product Market

4. The parties overlap in the manufacture and supply of pipes and fittings. They take the view that there are four categories affected by the transaction (defined by category of intended end use application), namely, pipes and fittings supplied in relation to: (i) above-ground drainage; (ii) below-ground drainage; (iii) internal water (plumbing); and (iv) utilities.
5. Previous EC<sup>1</sup> and UK<sup>2</sup> cases in this sector have defined product markets by reference to material and application. The competition constraints operating at each of these levels are analysed below.
6. The parties overlap in the manufacture and supply of pipes and pipe fittings in the UK as shown in Table 1. The largest overlap both by value and by product range is in the 'below-ground' drainage category.

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<sup>1</sup> See, for instance, Case No. COMP/M.1644, *Wienerberger / DSCB / Steinzeug*, decision of 17 September 1999; and Case No. COMP/M.2294, *Etexgroup / Glynwed Pipe Systems*, decision of 28 February 2001.

<sup>2</sup> See, for instance, DGFT's advice of 17 March 1999 in relation to the proposed acquisition by Hepworth Building Products Limited of certain assets of Naylor Industries plc, namely Naylor Drainage Limited, and Naylor Plastics Limited.

**Table 1: Summary of product overlaps by product category, material and UK 2003 sales (£ million)**

Product category	Wavin	HPB		
	Plastic	Plastic	Clay	Concrete
Rainwater	[<10]	[<10]		
Soil/Vent/Waste	[>10]	[<10]		
Total Above-ground drainage	[>20]	[>10]		
U-drain	[<40]	[>10]	[<20]	[<10]
Sewer-adoptable	[<10]		[<20]	[<20]
Sewer-surface water	[<10]	[<10]	[<10]	[<10]
Land drainage	[<10]			
Channel drainage	[<10]			
Water management	[<10]			
Total below-ground	[>40]	[<20]	[>30]	[<20]
Internal water (plumbing)	[<10]	[>20]		
Utilities (gas, water, telecom, power)	[<20]	[<10]		

Source: the parties.

Note: sales revenues rounded to nearest £ million.

7. On the demand-side, customers, competitors and external research tend to distinguish between pipes by reference to the four main categories of use, as set out in the table, i.e. above-ground drainage; below ground drainage; internal water; and utilities. In particular, differences in the type of application for which the pipes are being used influence the choice of product, especially the diameter of the pipe and the range of materials from which the system can be made.
8. No evidence has been put to us to suggest that there is substantial actual or potential supply-side substitution across the four product categories.
9. The parties have, however, presented evidence suggesting that there is significant scope for supply-side substitution between the plastic products within these categories. They have shown, for example, that certain of their machinery is able to produce pipes of different diameters and

strengths and have provided examples to show that this happens in practice, facilitated by a high level of spare capacity across the sector.

10. Within each of the four product categories there is some evidence that plastic faces some competitive pressures from other materials. The extent varies, however, according to application, as discussed further below.
11. Although it is possible to buy them separately, fittings and pipes are normally purchased together owing to concerns about systems integrity and product liability. The competitive conditions regarding pipes on the one hand and fittings on the other are similar and so they are analysed together in the rest of the paper.

### **Geographic market**

12. On the geographic scope of the analysis, the evidence points to the UK as being the best starting point for the assessment regarding pipes, for three main reasons. First, prices and price trends differ significantly between the UK and continental European countries; second, transportation costs are relatively high in relation to final value; and, third, product standards and building customs differ significantly between countries.
13. The parties state that there is a free flow of pipe system products between Northern Ireland and Great Britain and that the competitive conditions and players are the same in each territory, with some additional local competitors and products in Northern Ireland.
14. Pipe fittings are less bulky, higher value-added products suggesting that there might be greater competitive pressure on UK suppliers from suppliers elsewhere. Any such distinction, however, does not affect the competitive assessment in this case.
15. A national geographic market definition is consistent with previous cases in this sector<sup>3</sup>.

### **Conclusion on product market**

16. The starting point for evaluating this transaction is therefore as follows: pipes and pipe fittings supplied in the UK in respect of (i) above-ground, (ii) below-ground, (iii) plumbing, and (iv) utility categories, taking account of distinctions between products made from plastic and other materials.

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<sup>3</sup> See, for instance, in relation to the EC, *Wienerberger / DSCB / Steinzeug* and *Etexgroup / Glynwed Pipe Systems*, *Ibid.*; and, in relation to the UK, *Hepworth / Naylor*, *Ibid.*

## HORIZONTAL ISSUES

### Market Shares

17. Table 2 sets out the parties' UK shares of sales by product category, together with the value of the segment.

**Table 2: UK Shares of Supply by Product Category ( per cent)**

Product category	Plastic		Size of segment	All Materials		Size of segment
	Wavin	HPB		Wavin	HPB	
Rainwater	[>10]	[<10]	£75m	[<10]	[<10]	£120m
Soil/Vent/Waste	[>10]	[<10]	£100m	[<20]	[<10]	£120m
Total Above-ground drainage	[>10]	[<10]	£175m	[<10]	[<10]	£240m
U-drain	[<30]	[<20]	£120m	[<20]	[<20]	£170m
Sewer-adoptable	[<20]		£25m	[<10]	[>20]	£85m
Sewer-surface water	[<10]	[<10]	£45m	[<10]	[>10]	£65m
Land drainage	[<30]		£12m	[<30]		£13m
Channel drainage				[<10]		£30m
Water management	[<10]		£40m	[<10]		£40m
Total below-ground	[<20]	[<10]	£242m	[>10]	[>10]	£403m
Internal water (plumbing)	[<10]	[35-45]	£60m	[<10]	[>10]	£230m
Utilities (gas, water, telecom, power)	[>10]	[<10]	£170m	[<10]	[<10]	£240m

Source: the parties, based on internal estimates and publicly available data.

18. In the **above-ground** sector there is no evidence to suggest that the parties' position is likely to be a cause for concern. In particular, shares of supply are modest and independent market research reports note that growth has attracted many new entrants in recent years. No third party has expressed any concerns about competition in the category.

19. A similar conclusion applies in the **utilities** categories where, again, shares of supply are modest and no third party has expressed any concerns.
20. In the **internal water** category the parties have a high share of supply in systems made of plastic. Pre-merger consumer research shows, however, that at least [10-30] per cent of the parties' customers would switch to systems made from copper if plastic-made systems increased in price by [5-10] per cent. (Copper still accounts for around three-quarters of all internal pipe systems). Put together with cost data, the evidence suggests that such a price increase would not be profitable. This indicates that the shares of supply for internal water pipes of all materials ([<20 per cent]) are likely to be a better indicator of the parties' competitive position than the figures relating to plastic alone. This is consistent with the parties' assessment as set out in pre-merger internal documents and also with independent market research reports.
21. In this category there is also evidence of successful entry into this segment over recent years, e.g. Polypipe (1998), Wavin itself (1999) and Aliaxis (through its subsidiary Marley) (1999). These three companies have grown quickly to account for over one quarter of thermoplastic pipe systems sold in the UK. Moreover, in the past five years thermoplastic systems have doubled their overall share of the internal water segment. Furthermore, there is evidence to show that entry has put downward pressure on prices and that it has taken place as part of a process of competitive innovation in new types of product and material.
22. In each case, however, it is worth noting that the new entrants were already present in other pipe system segments. This suggests that an established reputation with building merchants might be important to obtain distribution.
23. Overall, however, the evidence does not suggest substantial competition concerns relating to this segment taken on its own.
24. In **below-ground drainage** category the parties' combined share of supply will exceed 25 per cent in U-drain plastic products, U-drain products (all materials) and in the sewer adoptable segment (all materials), as shown in Table 2. This is the category that has elicited most third party comment.
25. U-drain pipe systems are used to transport rainwater, waste water and soil water from houses or buildings to the public sewer system. Adoptable sewer pipe systems are used for public sewers. The term refers to the fact that, once a new drainage system is connected by a house-builder or

contractor to the public sewage system, the local water utility assumes ownership of certain of the assets, a process known as 'adoption'.

26. The evidence from the parties and from some third parties suggests that this might be too narrow a segmentation in this case, however, given that key products (both plastic and clay) are used in u-drain, adoptable sewer and sewer surface water applications. The parties also argue that in many cases they do not know for which application a given system will be used by the purchaser. In these circumstances they are unable to price according to precise application.
27. There is also some evidence to suggest that, in the past, there has been competition between products made of different materials in the below-drainage category. In particular, regression analysis undertaken by the OFT suggests that the price of clay and concrete has been positively and significantly correlated with the volume of plastic sales. Market research evidence suggests, however, that much of the product substitution potential might have already occurred<sup>4</sup>, as those most likely to switch to plastic will probably have already done so following the introduction of plastic products over a number of years. If so the competitive interplay between materials might be weaker in the future, a point that some third parties have also made.
28. Even on a wide view (below drainage, all materials), however, the share of supply figures set out in Table 3 might suggest that this transaction represents a potentially significant increase in concentration on conventional measures, though from a low level: the pre-merger HHI is around [ $<1000$ ]; the increment is [ $<400$ ].

**Table 3: Key UK shares of supply in below-ground drainage ( per cent, value, 2003)**

<b>Company</b>	<b>Share of supply</b>
Wavin	[<15]
HPB	[<20]
Aliaxis	[<10]
Polypipe	[<20]
CPM Concrete	[<10]
Johnston Concrete	[<10]
Stanton Bonna	[<10]
Uponor	[<10]
Naylor	[<10]
11 other companies	[>30]

Source: the parties.

29. A number of pieces of evidence, however, suggest that this share of supply position does not indicate a significant lessening of competition across the category.
30. First, many players in the industry have significant spare capacity. Evidence from individual tenders and from customer representations suggests that this has facilitated competition, including from smaller competitors, and especially given the scope for switching of production between products in different subcategories.
31. Even in the hypothetical scenario that the parties removed all their excess capacity, according to the parties, there would remain high levels of overcapacity among other suppliers.

#### **Barriers to entry and expansion**

32. Second, barriers to entry do not appear to be high. The parties (and some third parties) have provided data that suggest that financial barriers to entry are unlikely to be high. Product certification and accreditation arrangements notwithstanding, entry appears to be possible within two years and possibly much more quickly. Although supplier reputation is important to customers, there is little indication from customers that it is a strong constraint on entry, especially taking into account the potential for an entrant to utilise an existing reputation in adjacent products.

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<sup>4</sup> See for instance the MBD report on *UK Tubes and Pipes*, 2004.

33. Examples of recent entry into the below-ground drainage sector include Emtelle (2000), Naylor (2000), Delleve (2002) and WT Burdens (2003).

#### **Buyer power**

34. Third, buyers have considerable negotiating power, especially the large national merchant chains and house-builders. Business is routinely awarded by competitive bidding and many customers multi-source, especially the merchants. Substantial levels of excess capacity among suppliers may also have strengthened their position.
35. There is also evidence that large customers are able to sponsor entry. WT Burdens, a national merchant, has recently introduced an own-label brand of plastic drainage products sourced from Emtelle, which was historically a cable ducting supplier.
36. The strong balance of customer evidence is that the present transaction will not weaken significantly, if at all, their overall negotiating position. If there is any concern at all, in relation to buyer power, it relates to the position if further consolidation were to occur beyond this transaction.

#### **Substitution by material type**

37. Previous cases have tended to take a cautious view about substitutability of products between applications and between materials. Part of the reason for caution here too is that the choices in terms of material appear to be influenced by two interrelated factors: diameter of pipe, and the specific nature of the application. A question arises, therefore, as to whether the transaction might raise competition issues in very specific parts of the below-ground sector.
38. Market research reports describe key advantages of plastic as being: high resistance to chemical attack; flexible production in terms of pipe length, which avoids the need for joints and therefore reduces the potential for leakage; and lower installation costs due to its light weight and flexibility.
39. Substitution potential for plastic has in the past been restricted in the water sector because of some water companies suspending the use of plastic pipes for sewerage because of fears that they can be harmed by rats and by high pressure water jetting. These restrictions have, however, eased in the past two years so that only three water and sewerage companies now have onerous restrictions in place. It is worth noting here

that no water and sewerage companies have raised serious concerns about this transaction.

40. Information on the parties' products suggests that, in the below-ground categories, the parties' particular strengths lie in different materials: Wavin is particularly strong in plastic pipes; HPB's relative strength lies in clay products.
41. Two third parties estimate that HPB might have a share of supply in clay products of over 85 per cent (but there is no increase by this merger). However, if clay provides some competitive constraint on plastic (as some of the above evidence suggests) then it might be argued that the merger could eliminate a significant element of competition. Combining available data from the parties and third parties suggests that the parties' share of supply in the sub-segments where clay is used (i.e. u-drain and sewer-related applications) could be as high as 40 per cent if plastic and clay products are taken together.
42. Third party evidence does not, however, suggest that putting together the parties' plastic and clay businesses is likely to harm competition in respect of below-ground products. Even if plastic and clay products compete to some extent, the balance of the evidence suggests that the strongest competitive constraints for plastic products come from products also made of plastic, and likewise for clay. Moreover, the regression analysis cited above suggests that, if clay is regarded as providing some constraint on plastic then concrete products should also be taken into account, which returns the analysis to the wider view presented earlier.
43. Turning to diameter of pipe, market research shows plastic sales by value heavily concentrated in the smaller diameter pipes. By contrast it shows concrete as almost wholly used for pipes above 300mm in diameter. In the middle range (150mm to 300mm) plastic and clay are both strongly represented, together with structured wall plastics.
44. In the middle range of products (150mm to 300mm) - where the potential for substitution between plastic and clay is probably strongest - the parties' combined share of supply might therefore be significantly higher than the figures set out in Table 2, if both plastic and clay are taken into account.
45. There is no substantive evidence in this case, however, to support an hypothesis that there might be significant competition concerns in this segment. In particular, no third party competitor or customer has put forward substantive concerns or provided evidence that the competitive

dynamics of the business might be significantly different here (e.g. that they have less buyer power or that barriers to entry are higher). Neither is the hypothesis consistent with evidence from a range of internal documentation supplied by the parties.

## **VERTICAL ISSUES**

46. There is no evidence to suggest that significant vertical issues arise in this case.

## **THIRD PARTY VIEWS**

47. Third parties expressed a range of different views about the way in which the sector operates. In particular, the parties' views on the ease of supply-side substitution came under some challenge. As a result detailed information was sought from the parties to help inform the analysis in these areas.
48. Despite these differences of view, however, the majority of customers and competitors who have expressed a view say they are largely unconcerned by the transaction, either overall or in respect of any particular product category. Where concerns have been raised they have tended either to be general observations about the size of the merged firm or uneasiness about the implications of any future consolidation.
49. Many of those invited to comment on the transaction, especially smaller customers, have not put forward any views.
50. We have received no unsolicited views.

## **ASSESSMENT**

51. The merger will result in the creation of fairly high shares within certain segments of the supply of pipes and fittings. However, a number of factors have led the OFT to conclude that this will not have a significant adverse impact on competition. First, there is significant unused capacity within the industry. Second, barriers to entry and expansion are currently relatively low. Third, there is evidence of considerable buyer power that will not be significantly affected by the transaction.
52. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

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