

## Anticipated acquisition by Hill & Smith Holdings plc of Assets of Lionweld Kennedy Limited

The OFT's decision on reference under section 22(1) given on 24 February 2005. Full text of decision published on 13 April 2005.

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

### **PARTIES**

1. **Hill & Smith Holdings plc** (H&S) controls a group of companies active in the manufacture and supply of products used in the building, construction and engineering industries. **Lionweld Kennedy Limited** (Lionweld) manufactures, supplies and installs industrial metal flooring, crash barriers and secondary metalwork.

### **TRANSACTION**

2. H&S made the acquisition of parts of Lionweld<sup>1</sup> (the Lionweld business) while Lionweld was in administrative receivership. The OFT believes that the assets acquired constitute an 'enterprise' for the purpose of section 23(1)(a) of the Enterprise Act 2002. In the year ended 31 December 2003, the acquired business' turnover was £14.1 million. The completion date for the acquisition was 27 October 2004.
3. H&S provided information concerning the transaction to the OFT on 17 December 2004. The extended statutory deadline is 1 April 2005.

### **JURISDICTION**

4. As a result of this transaction, H&S and the Lionweld business have ceased to be distinct. Lionweld's UK turnover does not satisfy the test in section 23(1)(b) of the Enterprise Act 2002 (the Act). However, the parties' combined share of supply in

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<sup>1</sup> Comprising two freehold properties, plant and equipment, stock and goodwill associated with businesses of the flooring, highways and galvanizing divisions of Lionweld. The consideration paid was approximately £2.6 million – source: [www.hsholdings.co.uk/press\\_releases/lionking20\\_12\\_2004.htm](http://www.hsholdings.co.uk/press_releases/lionking20_12_2004.htm)

the UK of (a) crash barriers and (b) standard metal flooring panels, exceeds 25 per cent in each case. The share of supply test in section 23 of the Act is consequently met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created. The ECMR does not apply.

## **RELEVANT FRAME OF REFERENCE**

### **Product market**

5. The parties overlap in the supply of three distinct products:

- (1) galvanised steel crash barriers
- (2) standard metal panels for industrial flooring, and
- (3) fabrication services in industrial flooring.

6. For completeness, it should be noted that the parties also overlap in hot dip galvanising. H&S currently has a [16 – 30] per cent share of supply of hot dip galvanizing in the UK. However, of the total of [10 – 20,000] tonnes of steel galvanized by Lionweld in 2003, [10 – 20,000] tonnes were for in-house supply. The remaining tonnes supplied to external customers account for only a [1 - 15] per cent share of the UK and Ireland jobbing galvanizing market. Such an increment is unlikely to raise competition concerns and is not considered further in this paper.

### **Product: galvanised steel crash barriers**

7. The purpose of crash barriers is to absorb and deflect vehicle impact. They are manufactured in various forms, including ‘tension corrugated beams’ (TCB) to form the central barrier on highways (motorways as well as certain trunk and urban roads) or as ‘open box beams’ (OBB) which are square sections used on approaches to bridges, turn-offs etc.<sup>2</sup>
8. Crash barriers are made from sheets of steel that are punched, pressed and welded into shape before being hot dip galvanized and fitted with carbon steel bolts. They are manufactured and installed to varying specifications according to their end purpose. Nonetheless, the method of manufacture is broadly similar for each type of crash barrier and all manufacturers produce all types. All such crash barriers have had to meet with design standards set by the Highways Agency. As of April 2005, these crash barriers will be required to meet with a European-wide standard for safety and testing: EN 1317.

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<sup>2</sup> A small proportion of crash barriers are also used in off-road applications such as in car parks, around buildings and on housing estates.

9. The notifying party submits that there are two distinct segments in the supply of crash barriers, viz:

- a. **The 'jobbing' segment for installation**

The majority (some 80 per cent) of sales of crash barriers are to fencing subcontractors who undertake the installation on behalf of larger construction companies. Supply contracts are not generally long term, and prices are negotiated with the manufacturers as and when work for crash barrier installation is subcontracted to the customers concerned. Subcontractors have indicated that switching between sources of supply is extremely easy and occurs frequently from job to job.

- b. **'Term maintenance'**

Repair and maintenance on crash barriers that have already been installed is undertaken by principal contractors. Term maintenance contractors procure replacement crash barrier components directly from manufacturers and tend to negotiate annual contracts at a fixed price.

10. Customers, however, have indicated that there is no difference in the requirements for the supply of crash barriers within the 'jobbing' and the 'term maintenance' segments. Identical units of crash barrier product are used in each case. Moreover, there is no reason why a manufacturer of crash barriers supplying the jobbing segment could not compete for a term maintenance contract. Indeed, until 2003 the three main crash barrier manufacturers all supplied crash barrier components for the term maintenance segment. Consequently, it does not seem necessary to segment the product frame of reference according to the two types of customer group discussed by the notifying party.
11. Installers of crash barriers have stated that they are unlikely at present to switch from the purchase of galvanised steel crash barriers to procuring any other type, such as those made from concrete – although this situation may well change in the near future when the EN 1317 standard is fully adopted in the UK.
12. Given that a narrower product frame of reference applies at the time of writing, however, the analysis in this paper is on the basis that the relevant product market to consider is that for galvanised steel crash barriers.

## **Geographic market for galvanised steel crash barriers**

13. Third party respondents indicate that, currently, the geographic frame of reference is the UK, but within a short time frame it is likely to become EU-wide.
14. As mentioned in paragraph 8, all crash barriers installed on UK highways have to adhere to particular design specifications set by the Highway Agency. This regulatory requirement acted as a restriction on European imports. A consequence of the application of the EN 1317 standard is that any European manufacturer of crash barriers – of all types – that meet with design, safety and performance criteria in that standard is eligible to have his product registered on the Highway Agency's acceptance list. The procedure is relatively straight-forward and design approval will typically take between two and three months.
15. There has been considerable interest from a number of European manufacturers. Of the 22 crash barrier products so far approved by the Highway Agency, 17 are from European competitors. The Highway Agency expects that there will more imports from continental Europe in the near future and considers that the geographic scope of the market is moving rapidly from being UK-wide to becoming European-wide.
16. Third party respondents have all proposed that the application of the EN 1317 is likely to significantly increase imports into the UK of crash barriers manufactured in Europe.
17. At present it is estimated that imports account for approximately £1 million in value of European-manufactured crash barrier components (such as steel beams) which are subsequently used in conjunction with other components manufactured in the UK.
18. H&S estimates that, on average, transport costs for European imports of crash barrier units account for 9 per cent of product value. Average transport costs for the shipment within the UK of crash barriers manufactured at the national level are estimated to be 5 per cent of product value.
19. No other significant barriers to trade have been identified. Customers considered that transport costs were not significant and could be offset against the lower prices offered by the larger European suppliers. A concern was raised over the ability of manufacturers outside the UK to make timely deliveries, given the short lead times involved in some fencing contracts: sometimes as little as seven days between the award of the contract and the target date for installation. However, it was submitted that the majority of European manufacturers whose products have been approved for use in the UK have agents here who can undertake and manage timely importation, delivery and sale of crash barriers to UK customers.

20. At present, therefore, the geographic scope for the sale of crash barriers appears to be the UK. However, imports and competition from European manufacturers is expected in the near future and is likely to broaden the geographic scope considerably.

**Product: standard panel flooring**

21. Standard panel for flooring are metal gratings made from sheets or bars of steel and other metals. Specialist machinery is used to press the steel into meshed panels of various standard sizes.<sup>3</sup> Standard panels are then sold to fabricators – either directly or through distributors.
22. Fabricators cut and weld the standard panels into bespoke shapes in order meet with the end customer’s specific requirements. The fabricated product is used in applications such as heavy-duty floorings (e.g. walkways in oil rigs and grated access platforms in the petrochemical sector) or in lightweight applications (side panels, barriers, some architectural installations and multi-use sport and gaming facilities etc.).
23. Customers have indicated that they would not be able to switch to alternative products in the event of a general rise in the price of standard panels, though substitution between various sizes of panel is possible in some cases.
24. On the supply side, it appears unlikely that timely new entry into the supply of standard panels would be possible without significant investment. The machines for forge welding the metal used to make such panels cost between £1 million to £8 million and require a source of high-capacity single phase electric power.
25. It seems reasonable, therefore, to conclude that the relevant product frame of reference is that for the supply of standard flooring panels.

**Geographic market for standard flooring panels**

26. H&S (through its subsidiary, Redman Fisher Engineering Ltd) and Lionweld are the only two UK-based manufacturers of standard flooring panels. The merged entity’s competitors import from Europe and the rest of the world. Approximately [16 – 30] per cent of panels produced by H&S and [16 – 30] per cent of panels produced by Lionweld were exported from the UK to customers (fabricators) in Ireland, Norway, Saudi Arabia and Dubai who supply fabricated flooring units mainly to the petrochemical industry.

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<sup>3</sup> The most common size is 6m x 1m for steel, stainless steel and aluminium

27. Customers have indicated that, in the event of a price rise by UK manufacturers, they would begin importing standard panels from the EU. Several respondents have indicated that they have switched recently to imported sources of supply. Transport costs do not appear to be significant and, according to a number of customers, can be more than offset against the lower prices offered by non-UK manufacturers. The majority of imports meet the ISO 9002 quality criteria (determined by the machine used to manufacture the panels). However, some concerns were raised with regard to the volatility of exchange rates and delivery lead times.
28. Consequently, the geographic frame of reference for the supply of standard flooring panels appears to be at least EU-wide, if not wider.

#### **Product: fabrication services in industrial flooring**

29. H&S and Lionweld overlap in their operations as fabricators of the type described in paragraph 21.
30. Customers requiring fabrication services undertake separate negotiations with fabricators for each individual order, the vast number of which are of low value (typically £10,000 or less).<sup>4</sup> Customers have indicated that they are able to switch between fabricators with ease.
31. On the demand side, fabrication is a necessary process in the installation of industrial flooring. Switching to an alternative process in response to a general price rise is unlikely.
32. On the supply side, those suppliers of standard panels who do not already offer fabrication services could begin providing such services relatively easily. The know-how is similar and the requirement for additional factors of production (labour, equipment for welding and cutting etc) is modest. Third party cost estimates are in the region of £5k to £10k.
33. The relevant product frame of reference considered in this paper is that for the supply of fabrication services in industrial flooring.

#### **Geographic market for fabrication services in industrial flooring**

34. The supply of fabricated services appears to be at least UK-wide, if not EU-wide in geographic scope. For customers who buy the product in order to supply industrial flooring, business is conducted at an international level and deliveries are made worldwide. Customers in the UK, however, are more likely to procure fabrication services from a UK fabricator even where the product itself is imported. The

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<sup>4</sup> It should be noted, however, that a few such contracts may be valued at closer to £1 million

question of the geographic scope for the supply of fabrication services can be left open, however, since there are no readily identifiable concerns for competition in this area of overlap.

## HORIZONTAL ISSUES

### Supply of galvanised crash barriers

35. The UK shares of supply in steel crash barriers of the merged entity and those of its main competitors in the UK are tabulated below. These shares of supply are calculated by value and include the jobbing and maintenance contract segments.

**Table 1: Crash barrier UK shares of supply for 2004.**

	UK - Supply of crash barriers to the open market		UK - Total supply of crash barriers	
	Turnover £million	%supply share	Turnover £million	% supply share
<b>H&amp;S</b>	1-15	46-60	1-15	31-45
<b>Lionweld</b>	1-15	1-15	1-15	1-15
<b><i>Combined</i></b>	<b><i>1-15</i></b>	<b><i>46-60</i></b>	<b><i>1-15</i></b>	<b><i>31-45</i></b>
<b>Corus</b>	1-15	31-45	1-15	16-30
<b>Balmer Lindley</b>	1-15	1-15	1-15	16-30
<b>Imports</b>	1-15	1-15	-1-15	1-15
<b>Total</b>	<b>20</b>	<b>100</b>	<b>24.9</b>	<b>100</b>

Source: OFT estimates based on information supplied by Hill & Smith and third parties.

36. Table 1 indicates that the merger has resulted in the merged entity having a combined share of [46 – 60] per cent (increment 10 per cent) of the supply of crash barriers to the open market and a reduction from three to two UK manufacturers. On the basis of the frame of reference comprising the overall supply of all crash barriers in the UK, the merged entity will have a share of [31 – 45] per cent - an increment of 8 per cent - and a reduction from four to three UK manufacturers.
37. Notwithstanding the high shares of supply and increase in concentration, there are a number of factors which alleviate any potential competition concerns arising from the merger itself.
38. Firstly, H&S submits that Lionweld was facing increased financial difficulties and was losing customers and contracts. Its problems with cash flow had compelled it to make spot purchases of steel – rather than allowing it to benefit from standard six month forward purchases. These spot purchases were made a time when the

price of steel had risen substantially and made a significant impact on Lionweld's raw material costs. By contrast, its competitors continued to make forward purchases of steel and did not incur such steep cost increases. Consequently, the parties submit that Lionweld was not in a position to price its steel crash barriers competitively. Documentary evidence provided by the parties shows that:

- a. Due to price competition in the Highways division, Lionweld was unable to pass on to its customers the increases it had incurred in the cost of steel;
  - b. Lionweld experienced operational and financial problems and lost a major Irish contract; and
  - c. credit insurance was withdrawn from the group, resulting in difficulty in sourcing raw materials on credit terms and a consequent cash drain.
39. This is further evidenced by the reduction of Lionweld's year on year share of supply from approximately [16 – 30] per cent in 2003 to [1 – 15] per cent in 2004, and ultimate receivership later that year.
40. This point is confirmed by a number of customer respondents who stated that Lionweld was becoming increasingly uncompetitive, unreliable and unable to match prices offered by Corus and H&S. Customers also indicate that in the six months prior to bankruptcy, Lionweld was no longer able to bid for larger jobbing contracts and a number of customers had stopped placing orders with Lionweld altogether. In the months prior to the acquisition, Lionweld had already lost a large number of 'jobbing' contracts and an increasing number of significant term maintenance contracts and no longer posed a credible competitive constraint on Corus and H&S. In view of this, it is doubtful as to whether the figures relating to its 2004 shares of supply are meaningful indications of the future constraint it would have imposed on its competitors absent the merger.
41. In addition, Lionweld's financial accounts indicate that it was not able to cover interest payments due to its creditors. H&S submits that, if the acquisition had not taken place within a period of three weeks of the actual completion date, Lionweld would have ceased trading altogether. This assumption has been corroborated by an examination of Lionweld's accounts.
42. By contrast, Corus supplies approximately [31-45] per cent of crash barriers to the open market in the UK and acts as a strong competitive constraint on the merged entity. The absence of any substantial switching costs and the fact that quotations are usually requested from all manufacturers whenever contracts go out to tender, would make it very easy for a customer to take business elsewhere should the merged entity increase prices. Customers have also indicated that the post-merger competition between Corus and H&S has continued to be rigorous.

43. A further factor that reduces competition concerns is the implementation of the European EN 1317 standard. As discussed above, following the application of EN 1317 any European manufacturer of crash barriers that meet with the design and performance criteria in EN 1317, are entitled to have their product added to the acceptance list maintained by the UK Highway Agency.
44. The Irish National Road Authorities<sup>5</sup> (INRA) fully adopted the EN 1317 standard in early 2002. At present INRA has on its acceptance list 66 individual approved crash barrier specifications from approximately 25 different manufacturers based in Germany, Italy, Sweden, France and the UK. INRA has also informed the OFT that, prior to the adoption of the EN 1317 standard, around 90 per cent of the crash barriers installed in Ireland were imports from UK manufacturers. Since then, however, the majority of new or replacement installations use crash barrier units manufactured in continental Europe. INRA also confirmed that UK manufacturers are competing with European manufacturers in Ireland. INRA also submitted that the UK manufacturers have lost shares of supply to European competitors.
45. Third parties contacted have all proposed that full application of the EN 1317 standard in the UK is likely to increase the import of European crash barriers imports significantly.
46. On the basis of a wider EU geographic frame of reference, H&S estimates that the total value of the supply of crash barriers in 2004 was approximately £200 million. Its share of supply to a wider European market would amount to some [1 – 15] per cent with sales amounting to £11 - 20 million in value.
47. Finally, customers consider that the Highway Agency's recent announcement that in future, all central reserve barriers on motorways, with a traffic flow greater than 25,000 vehicles per day, will upon renewal be changed from galvanised steel to concrete, is likely to result in a substantial reduction in future demand for steel crash barriers in the UK.
48. Although barriers to new entry into the manufacture and supply of crash barriers are estimated to be relatively high, they are not insurmountable. To manufacture all the components of a crash barrier system, and supply approximately 5 per cent of the market, it is estimated that investments in plant and machinery of roughly £450-650k would be required. In addition to this, a new entrant would require additional investments for R&D and testing of approximately £1 million. The timescale required for a new entrant is estimated to be approximately 9-12 months. For a company which already possesses the prerequisite expertise, total start up costs are estimated to amount to £1 million and the production process could begin within 6-8 months. Upon exit it is estimated that approximately 50 per cent of plant and machinery costs would be recoverable and parts of R&D investment could be recoverable if crash barrier designs were patented.

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<sup>5</sup> The equivalent of the UK Highways Agency in the Republic of Ireland

49. Notwithstanding the above, a customer respondent informed us that two fencing subcontractors have in the recent past set up their own manufacturing facilities and a third can produce some components. One relatively new entrant invested less than £2 million in order to become a self-sufficient high volume manufacturer of crash barriers.
50. One larger fencing subcontractor has indicated that, should the merged entity raise prices to enhance profit margins, it would begin either manufacturing its own crash barriers or importing from Europe. In particular it claims that it has the capability and financial strength to do so and that the merged parties are aware of this possibility. The feasibility of new entry and the loss of a large customer is likely to act as further competitive constraint on the merged entity.
51. The majority of customers consider that they have buyer power. They can switch supplier easily and are aware of each manufacturer's prices. The realistic potential for self supply by larger customers also gives these customers an additional degree of negotiating strength.
52. A third party raised the concern that the merged entity would be able to use its market power to bundle crash barriers with other products it produces. Notwithstanding, it did not consider that the merger had substantially lessened competition. No other party raised this concern.
53. All the factors discussed above indicate that competition in the supply of crash barriers in the UK has not been substantially lessened post acquisition. The loss of competitive constraint posed by Lionweld is negligible given the impact that its financial difficulties had had on its ability to compete effectively, thus accelerating its commercial decline and leading subsequently to receivership. Constraint will nonetheless continue to be posed on the merged entity by keen competition from Corus, the imminent prospect of European imports in the near future and a realistic threat of new entry.

#### **Supply of standard panels**

54. The 2003 UK and EU shares of supply in standard panels of the merging entities, and those of their main competitors are tabulated on the following page.

**Table 2: Standard Panels UK and EU shares of supply for 2003.**

Company	UK		EU	
	Turnover £ million	%	Turnover £ million	%
<b>H&amp;S</b>	1-15	16-30	1-15	1-15
<b>Lionweld</b>	1-15	1-15	1-15	1-15
<b>Combined</b>	<b>1-15</b>	<b>31-45</b>	<b>1-15</b>	<b>1-15</b>
<b>Lichtgitter UK</b>	1-15	16-30	1-15	16-30
<b>Meiser</b>	1-15	1-15	1-15	16-30
<b>Elefant<sup>6</sup></b>	1-15	16-30	No information	No information
<b>Sangjin</b>	1-15	1-15	NA	NA
<b>Mentis</b>	1-15	1-15	NA	NA
<b>Staco</b>	No information	No information	1-15	1-15
<b>Others</b>	1-15	1-15	16-30	31-45
<b>Total</b>	<b>12.6</b>	<b>100</b>	<b>52</b>	100

Source: Hill & Smith best estimates

55. The merged entity has a combined UK share of supply of [31-45] per cent with an increment of 13 per cent. At the European level its share of supply is [1-15] per cent, an increment of 4 per cent.
56. Although it is the only UK-based manufacturer of standard panels, the merged entity will continue to face competitive constraint from a number of smaller suppliers who import standard panels. Lichtgitter and Meiser both manufacture standard panels in Europe and import the product through their satellite companies in the UK. Lichtgitter and Meiser also compete with H&S and Lionweld in other European countries.
57. Given the very low switching costs and the broad homogeneity of the product, most customers indicated that they would readily switch to an importer or import the product from abroad themselves.
58. Some customers submitted that H&S' standard panel prices have risen since the merger. These respondents have started purchasing from alternative suppliers at more competitive prices or are arranging for supplies to be imported themselves.
59. Nonetheless, a number of customers are fairly small companies that are not always familiar with the available options for alternative sources of supply. Such companies, by their own admission, do not make a priority of identifying competing suppliers or of seeking quotations from a number of firms.

<sup>6</sup> Elefant have informed the office that they do not produce standard 6x1m mats. They produce smaller finished mats. They have however, stipulated that customers consider the two substitutes and that they compete with the merged entity.

60. Entry barriers appear to be quite high. In particular, the machinery required for forge welding the steel costs in the region of £1-8 million and in addition a very strong source of high-capacity single phase electric power is necessary. This power supply is only available at a few sites in the UK and getting the power to a site would cost roughly £1 million. This results in a sizeable investment which would take several years to amortize.
61. The majority of customers contacted stated that they had the ability to negotiate favourable prices, though some claim that this has been dampened following the merger.
62. There remains a number of alternative sources of supply within the UK and customers can easily switch to these or begin importing.

#### **Supply of fabrication services for metal flooring**

63. Based on UK figures for 2003, the merged entity will have a combined share of supply of [16-30] per cent in the UK based on an increment of 12.7 per cent. Nonetheless, there remains a very substantial number of smaller competitors: Lichtgitter ([1-10] per cent); BSG ([1-10] per cent); Meiser ([1-10] per cent); Steelway ([1-10] per cent); Guardrail ([1-10] per cent). All customer respondents have stated that switching costs are very low.
64. Entry barriers appear to be low. According to the parties start-up costs are between £5,000 - £10,000 and all that is required is extra simple tools and additional labour. This is evidenced by the low degree of market concentration. Customers of fabricators have also stated that they would be able to setup their own fabrication facility and indeed some already do.
65. Finally there have been no third party concerns with regard to fabrication.

#### **VERTICAL ISSUES**

66. In all areas of overlap, Lionweld and Hill Smith were active at the same level of the supply chain. Since the merger has not resulted in a significant increase in market power in any area of overlap, vertical competition concerns are unlikely to be an issue.
67. The only likely vertical impact this acquisition will have is increased buyer power for the merged entity with respect to its upstream steel supplier. No third party contacted had any vertical competition concerns.

#### **THIRD PARTY COMMENTS**

68. The majority of respondents were unconcerned by the merger. The concerns that were expressed, however, were as follows: two crash barrier customers had some concerns regarding the reduction in the number of manufacturers; for standard

panels, some concerns were raised as to the time it would take customers to find any alternative suppliers.

## **ASSESSMENT**

69. The weight of the evidence suggests that this transaction will not substantially lessen competition in any area of overlap between the merging parties.
70. With regard to the supply of galvanized steel crash barriers, while the merger will lead to an increase in concentration and a reduction in the number of suppliers, there is evidence that Lionweld was no longer a credible competitive constraint following a substantial period of financial difficulty leading to the company going into receivership. Corus will remain a strong competitive constraint on the merged entity. Switching costs are very low. Moreover, the new requirements for application of the EN1317 standard makes the potential for European imports in the short run likely. The latter point has been confirmed by customers and competitors alike, as well as the INRA and UK Highway Agency.
71. With regard to the supply of standard panels, although the merged entity is currently the only UK manufacturer of standard panels, there are a number of competitors importing the product from Europe and the rest of the world. The product is relatively homogeneous and there is no significant difference in the quality of the product. Customers are price sensitive and have indicated that they can switch purchases to UK based importers or alternatively import directly from Europe themselves.
72. Finally, the merger will not significantly lessen competition in the supply of fabrication services in industrial flooring. The merged entity will continue to face competition from a large number of companies in the UK; customers are price sensitive and have indicated that they can easily switch to alternative suppliers. There were no third party concerns.
73. 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.
74. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.