

Fletcher Building's proposed acquisition of Insulation Solutions Holdings Pty Ltd

The Australian Competition and Consumer ACCC (ACCC) announced on 3 February 2005 that it would not intervene in the proposed acquisition by Fletcher Building Ltd (Fletcher) of Insulation Solutions Holdings Pty Ltd (ISPL) from the Amatek Group (Amatek).

The ACCC made its decision on the basis of information provided by the parties and information arising from its market inquiries.

Timing of the ACCC's consideration

On 11 November 2004, the ACCC commenced market inquiries into the proposed acquisition.

On 12 January 2005, the ACCC decided to conduct further inquiries to determine the likely level of competitive constraint arising from actual and potential imports of glasswool insulation products.

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The parties

Fletcher is a New Zealand based company which manufactures and supplies a range of building materials in Australia. Through its subsidiary, Tasman Insulation Australia, Fletcher manufactures and distributes glasswool, reflective foil and polyester insulation products.

ISPL manufactures and distributes glasswool and reflective foil insulation products across Australia.

The transaction

Fletcher proposes to acquire all of the issued shares in ISPL.

Market Inquiries

The ACCC contacted a number of competitors, importers, customers and industry bodies as part of its market inquiries.

Market definition

The parties overlap in relation to the manufacture and distribution of glasswool and reflective foil insulation products.

Product dimension

Insulation products are primarily used for residential and commercial building and industrial applications for their thermal, acoustic and/or condensation control properties. Applications in residential and commercial buildings include roof, ceiling and wall (or partition) insulation. Industrial applications include: original equipment manufacturing; insulating low and high temperature pipes and air-conditioning systems; and cold insulation applications.

Commonly used insulation products include glasswool, rockwool, reflective foil, polyester, cellulose and polystyrene. The ACCC's investigation found that the level of substitution between glasswool and other insulation products varied considerably between different applications which reflected a range of price and non-price considerations by customers in making their insulation purchasing decisions. Non-price considerations raised by market participants included product specifications, quality, building practice variations across different regions and occupational health and safety (OH&S) issues perceived to be associated with mineral fibre products (glasswool and rockwool).

The level of substitution to non-glasswool insulation products at an industry wide level is significant. For example, information before the ACCC suggests that sales of non-glasswool products account for approximately 60% of total national insulation sales. The ACCC noted that alternative products are considered to be the leading product in several applications, such as for partitions in commercial buildings, where polyester appears to have captured the dominant share due to perceived OH&S issues associated with glasswool, and for acoustic and high temperature applications where rockwool is considered to be the leading product given its higher density and higher melting point. In respect of residential and commercial applications, the ACCC noted that the Building Code of Australia (BCA) is a non-product specific insulation requirement, in that customers are able to determine how best to meet the required thermal and acoustic rating with a range of glasswool and non-glasswool insulation products available to them.

However, the ACCC's inquiries indicated that substitution to non-glasswool products appeared more limited in respect of residential roofing, commercial roofing, residential ceiling and residential wall applications, where glasswool batts and reflective foil-faced glasswool blankets are the leading products. While reflective foil alone is used in residential and commercial roofing, the evidence before the ACCC suggests that reflective foil is a complement to glasswool rather than a substitute. For example, reflective foil is commonly used under tiled and terracotta roofs in combination with glasswool ceiling insulation and as a facing to glasswool blankets under steel roofs.

The ACCC's view is also based on the very limited applicability in Australia of cellulose in respect of roofing and wall applications due to its loose-fill nature. Further, at higher thermal ratings cellulose may have limited applicability due to its weight and obscuring ceiling joists. In relation to polyester products, the ACCC noted the significant price differential that currently, and is likely to exist, in favour of glasswool when compared with polyester. Evidence before the ACCC indicates that this price differential does, and would likely continue to, significantly inhibit substitution to polyester products in respect of the above applications. In this respect, the ACCC's inquiries and independent studies suggest that residential builders are more price sensitive than other users.

On the supply-side, the ACCC considered that glasswool manufacturers imposing a small but significant and non-transitory increase in price (SSNIP) would face limited competitive

constraint from a non-glasswool manufacturer switching to glasswool manufacture due to the high capital costs and lengthy lead times involved in establishing glasswool manufacture.

Geographic dimension

While there appear to be significant State-based dynamics in the insulation industry, such as different BCA requirements for different climatic regions and variations in State-based market shares, the ACCC considered the relevant geographic dimension to be national in scope. The ACCC noted that insulation products, although bulky, are readily transportable and interstate delivery is viable. For instance, the parties' insulation products, manufactured in Sydney and Melbourne, are distributed and sold nationally.

Based on the above, for the purpose of competition analysis, the ACCC considered the relevant market to be the national market for the manufacture and wholesale supply of insulation products noting, however, limited substitution to non-glasswool products in respect of residential roofing, commercial roofing, residential ceiling and residential wall applications.

Market concentration s 50(3)(c)

On the basis of a broader product dimension and the parties' market share information, the proposed acquisition would not exceed the ACCC's concentration thresholds for the unilateral or co-ordinated exercise of market power.

However, this matter is an example of a merger in which the ACCC's concentration thresholds were not exceeded, but nevertheless raised significant competition issues requiring extensive investigation and industry consultation. The ACCC considers that concentration thresholds are indicative only and will always consider other factors, as contained in section 50(3) of the Trade Practices Act.

Actual and potential import competition s 50(3)(b)

The ACCC consulted with independent importers and significant customers to determine the likelihood of actual and potential imports of glasswool batts and blankets providing a competitive constraint upon the merged firm. In coming to its view the ACCC received differing information from market participants and noted that reliable historic and current glasswool import data was difficult to obtain.

On the basis of information before it, the ACCC considered current levels of independent imports of glasswool to be low with estimates ranging from 1% to 6% of total national glasswool sales. However, it is evident that total glasswool imports have increased considerably in recent years as domestic glasswool manufacturers reached maximum manufacturing capacity as a result of, *inter alia*, the increased demand associated with mandatory insulation requirements under the BCA coming into effect and Australia's recent housing boom. In this respect, the ACCC noted the considerable growth of imports of glasswool blankets by domestic glasswool manufacturers in recent years.

The ACCC's inquiries suggest that independent imports of glasswool blankets, used in residential and commercial roofing applications, are significant with a number of importers on both seaboards currently supplying product from several overseas sources. Further, based on submissions from importers, the ACCC considered that importers of glasswool blankets have

been relatively successful in capturing sales from domestic glasswool manufacturers and their resellers.

Independent imports of glasswool batts are currently low on a national basis and the ACCC's inquiries indicate that imported batts are predominantly those being landed by Australian Gypsum Industries (AGI) in Western Australia. AGI is a related company to BGC - a large, Western Australian-based residential and commercial builder and building materials supplier.

The ACCC's investigation indicates that the supply of imported glasswool batts to the eastern seaboard is occurring, but is currently of a limited nature. This may reflect the presence of domestic glasswool manufacturers on the eastern seaboard. In Western Australia, however, the ACCC noted that imported batts have captured a significant share of glasswool demand. Further, inquiries also indicate that imported batts are being supplied at price competitive levels in Western Australia which may, in part, be due to domestic glasswool prices being higher in Western Australia due to the added freight component incurred by domestic manufacturers being located on the eastern seaboard.

In relation to potential imports, the ACCC considered that there would be a number of independent overseas manufacturers with spare capacity from which customers could source glasswool batts and blankets. Further, many of these sources utilise the same or equivalent manufacturing technologies and would therefore produce glasswool products of comparable quality to domestically manufactured glasswool.

Based on the significant penetration of glasswool blankets nationally and glasswool batts in Western Australia and the availability of independent overseas sources of glasswool products, the ACCC therefore considered that the merged firm would face a credible threat from imported glasswool that would be likely to prevent any exercise of market power by the merged firm.

Barriers to entry s 50(3)(b)

The ACCC considered that new entry to the manufacture and supply of glasswool is unlikely. This conclusion is based on the high capital costs, lengthy lead times and need to obtain manufacturing technology licensing required to establish a glasswool manufacturing facility. However, the ACCC noted that barriers to entry appeared to be relatively low for alternative forms of insulation, such as polyester, cellulose and reflective foil, where initial capital costs are much lower and there is evidence of recent entry.

Availability of substitutes s 50(3)(f)

On the basis of a broad product dimension, there would remain a number of competitors to the merged firm to whom customers could turn in the event of a SSNIP. This would include the remaining domestic glasswool manufacturer, CSR Bradford, and a significant number of suppliers of alternative insulation products.

Countervailing power s 50(3)(d)

Countervailing power exists when it is possible for a customer to by-pass the merged firm. This can be done by promoting an existing small player, encouraging a new entrant, vertically integrating or by importing. The ACCC considered that customers would likely possess some degree of countervailing power arising from the significant number of suppliers of insulation

products to which they could turn and the ability of customers to switch, or credibly threaten to switch, to glasswool imports, to defeat a SSNIP by the merged firm.

Conclusion

Accordingly, the ACCC considered that the proposed acquisition would be unlikely to have the effect of substantially lessening competition.