

Completed acquisition by Armstrong Pumps Ltd of Howard Anderson Ltd

The OFT's decision on reference under section 22(1) given on 2 June 2004

PARTIES

Armstrong Pumps Ltd (Armstrong) is based in Toronto and manufactures fluid movement equipment, principally pumps and associated pumping systems, for the building services industry world-wide. Armstrong's key products are fire pumps, pressurisation units, and commercial pumps. **Howard Anderson Ltd (HAL)** is based in the UK and was said to have been on the verge of imminent insolvency prior to the acquisition. HAL traded under the brands Holden Brooke and Pullen. HAL's turnover was approximately £20 million.

TRANSACTION

Armstrong Pumps acquired HAL on 2 February 2004. The extended statutory deadline is 16 June 2004 and the administrative timetable expires on 3 June 2004.

JURISDICTION

As a result of this transaction Armstrong and HAL have ceased to be distinct. The parties overlap in the supply of HVAC pumps and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. A relevant merger situation has been created.

RELEVANT MARKET

The parties overlap in the supply of HVAC pumps, which is a sub-sector of the Building Services Products sector. The UK HVAC pumps sector is estimated at £73 million per annum. This figure includes booster systems and pressurisation systems as these systems are often sold with the pumps as a package. The turnover for the pumps alone is estimated at £55 million per annum.

HVAC pumps are sold to construction companies through two routes: direct to the mechanical engineer or indirectly through wholesale distributors. Those products that go through distributors are typically mass produced smaller pumps that are typically used in domestic and smaller commercial applications.

Product market

The HVAC pump sector can be segmented into commercial and domestic HVAC pumps. Both domestic and commercial HVAC pumps carry out the same basic function: to circulate water. The main difference between them is simply one of size. On the **demand side**, it would appear that commercial and domestic HVAC pumps are not directly substitutable. However, the parties submit that it is possible for small commercial buildings to use larger domestic pumps (either alone or in combination) and for larger domestic buildings to use small commercial pumps. For this reason, it is difficult to categorise some of the mid-sized pumps as being either domestic or commercial. However, broadly speaking there are different customers (commercial HVAC pumps tend to be used in large buildings whilst domestic pumps are used by households) and large price differences between the two types of pump. On the **supply side**, third parties submit that the commercial and domestic HVAC pump sectors have different routes to market, different distribution and different methods of sale. In addition, it would not, for example, be easy to convert a domestic production line (mainly mass produced) to a commercial production line due to specialist machinery needed. Costs of switching would be very high.

The HVAC pump sector can, alternatively, be segmented into mass produced and made to order pumps. Nearly all domestic HVAC pumps are mass produced. The majority of commercial pumps are made to order. However, smaller, less complex commercial pumps can also be mass produced. On the **demand side** the parties submit that there is no difference in function between mass produced and made to order as all pumps circulate hot or cold water. It is possible to substitute multiple mass produced pumps for made to order ones. The difference comes in the technology used and the manufacturing techniques employed.¹ The large number of pressures and flows that might be wanted for a made to order product would be uneconomic to produce using mass production techniques. On the **supply side**, the parties believe that for made to order pumps, the machinery of manufacture is general machine tools employed in very many engineering environments. There is little, they contend, to prevent numerous engineering businesses from manufacturing a made to order pump. The parties believe that asymmetric supply side substitutability exists between mass produced and made to

¹ For made to order pumps, the impeller which agitates the water is machined to provide a specific pressure and flow. The pump body is a separate part of the construction and the motor is cooled by the ambient air. There is a mechanical seal around the shaft. The mass produced pump product employs a wet motor that is exposed to the water in the heating or cooling system. By doing this the need for a mechanical seal is eliminated, and the motor is cooled by the system water.

order HVAC pumps. Whilst it is easy for a mass produced HVAC supplier to enter the made to order sector, the reverse is not true. One producer holding a strong position in the mass produced pump segment seriously addressed the made to order segment four years ago and has since established a significant share of supply.

Vertical multi-stage pumps have not been included in the assessment of commercial HVAC pumps. It appears that these pumps are complements, rather than substitutes to commercial HVAC pumps.

It therefore appears that there is limited substitutability between commercial and domestic HVAC pumps. Given that Armstrong and HAL do not manufacture domestic pumps, domestic pumps are not considered further. The degree of demand and supply side substitutability between mass produced and made to order pumps is less clear. Analysis has therefore been carried out considering both a broader commercial HVAC pump sector and separately, the narrower made-to-order commercial HVAC sector.

Geographic market

The parties indicate that the geographic scope of the market is global/European. Many of the larger suppliers do not manufacture in the UK, but import from mainland Europe. The same companies are present across Europe and sell the same products into multiple European countries, including the UK. The parties submit that a national presence is not needed to supply, although it is helpful. There are many small regional pump distributors who cover a small geographical market only and who supply into both the mass produced and made to order markets. The parties state that an after sales field service team is not essential. In addition, it is not essential for manufacturers in countries other than the UK to obtain an accredited quality assurance system.

However, it is notable that the only recent entrants from outside the UK have all entered either through acquisition, or via existing subsidiaries currently supplying commercial HVAC pumps to the UK. The parties believe the lack of entry is probably due to low returns on investment, implying that companies could easily enter should price rise.

Furthermore, many third parties have indicated that the geographic scope is more likely to be UK wide. Some believe that the structure of distribution and sales is such that some form of local warehousing/sales/technical support is needed to import pumps into the UK. Although the available data indicates price differences between the UK and the other European countries in absolute terms, there are too few data points to establish any statistically robust trend.

Given that even on the narrowest possible geographic frame of reference (the UK) this merger is not considered to result in a substantial lessening of competition, it is not necessary to conclude on the geographic market.

HORIZONTAL ISSUES

Shares of supply

The parties estimate that they have a [20-30 per cent]² of the commercial HVAC pump sector (when defined by number of users) and [30-40 per cent]² share of the commercial made to order HVAC pump sector (when defined by manufacturing process).

However, some third parties believed that the parties' share of supply in the UK was much larger. It is unclear how the differences in estimates arise. We sought revenue figures from each of the main parties. Based on these revenues and estimates of total market value, combined shares of supply are not significantly different to Armstrong's estimates. On this basis, therefore, we have no reason to believe that Armstrong's own estimation of the parties' revenues and share of supply are substantially inaccurate. Regardless of the differences in estimates, it is, however, clear that Armstrong is small relative to HAL in the UK. This indicates that no matter what the true shares of supply, the increment will be fairly low. Moreover, using each company's own estimate of its revenue within the commercial HVAC sector, Grundfos is larger than a combined HAL/Armstrong.

Within the commercial sector, HVAC pumps are sold to construction companies through two routes: (i) direct to installing mechanical engineering contractors and then sold on to the building contractor; and (ii) through distributors who typically purchase mass produced smaller pumps and who supply pumps together with fittings and pipework. Procurement by mechanical engineering contractors for made to order pumps is on a project by project basis.

The parties submit that they have traditionally sold direct to contractors for the majority of their business.

It has been suggested by one competitor and some customers that Armstrong and HAL did not compete to any great extent pre-merger and that the main source of competition in the sector has always been between HAL and Grundfos. A large amount of pumps are tendered for (around 50 per cent of sales) and the parties have provided us with some bidding data. Having examined the bidding data, we do not consider the

² Figures replaced by a range at the request of the parties.

level of competition pre-merger between Armstrong and HAL to be particularly significant.

The data provided by Armstrong also shows – what some mechanical engineering firms as specifiers have said anecdotally – that HAL, Grundfos and Wilo are more likely to be specified than Armstrong. Others have suggested that they would have specified Armstrong alongside HAL, Grundfos and Wilo. The number of ‘open specification’, non specification and ‘or equal’ quotations is also an indication that specification does not lock customers into certain suppliers.

Barriers to entry and expansion

It has been suggested that the UK commercial HVAC pumps sector might be difficult to enter given the strength of the existing players and their brand reputation. Yet, it was submitted by the parties and confirmed by third parties that entry would be relatively easy through buying an existing pumps manufacturer in the Far East, and importing the pumps to the UK. One third party not currently active in the commercial HVAC sector is considering entering the UK commercial HVAC pumps sector either through acquiring or buying in products from an existing Chinese manufacturer. There are also European companies currently producing HVAC products who could enter the UK.

There are many independent distributors that sell pumps who are able to form channels for new entrants. In addition, there is nothing that technically prevents distributors, who already have a well known brand, from entering the commercial made-to-order sector should they wish to do so.

Buyer power

Customers for made to order pumps are mechanical and electrical contracting firms. These are predominantly medium or large companies which work for building contractors on a sub-contract basis. They are frequent and sophisticated purchasers and employ professional buying teams, which negotiate each and every order with the supplier. The parties submit that this has resulted in low profitability within the industry. The parties have provided us with specific examples of multiple rounds of negotiation in which the contractor plays one supplier off against another, thereby reducing prices.

Third parties have mixed views on countervailing buyer power. Some customers and competitors believe that customer size gives them negotiating power. Some competitors have suggested that the low number of suppliers on the commercial side means that little, if any, countervailing buyer power exists. Nevertheless, customers have a choice of at least five other suppliers, including Grundfos.

THIRD PARTY VIEWS

Of the eleven customers contacted, two expressed concerns that there are very few suppliers in the commercial sector and one less might lead to price increases. Three of the six competitors contacted have concerns. Again, they are concerned that there are few players in the commercial sector. Third parties that were not concerned believe that there was little competition between Armstrong and HAL pre-merger and that the main factor driving prices is the competition between HAL and Grundfos that will remain post merger. Some customers felt they had enough buyer power due to their own size and enough choice of supplier post-merger to avoid any price increases.

ASSESSMENT

Before the merger, the parties overlapped in the supply of HVAC pumps, specifically the manufacture of commercial, made-to-order HVAC pumps. The merger gives Armstrong a combined share of [20-30 per cent]² of all commercial HVAC pumps in the UK [30-40 per cent]² of the made-to-order segment alone.

Mixed views have been put forward on barriers to entry. There have been no recent examples of entry. However, most third parties agree that there would not be any technical difficulties in entering the commercial HVAC pumps segment. The easiest way to enter would appear to be through buying an existing pumps manufacturer in the Far East, and importing the pumps to the UK. Customers suggested that whilst they would not simply switch for the sake of trying something new, should they be faced with price increases, they would be willing to switch suppliers.

There appears to be a degree of countervailing buyer power amongst engineers and distributors. Many customers commented that their size provides them with power to negotiate on prices. Although the merger has resulted in the loss of one supplier, customers still have a choice of at least five others.

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

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