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Determination

IKO Industries Limited and Ross Roof Group Limited [2021] NZCC 8

The Commission:	Anna Rawlings Dr John Small John Crawford
Summary of application:	An application from IKO Industries Limited to acquire all of the shares of Ross Roof Group.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to the proposed acquisition.
Date of determination:	29 June 2021

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

The proposed acquisition

1. On 27 May 2021 the Commerce Commission registered an application (the Application) from IKO Industries Limited (IKO) to acquire all of the shares of Ross Roof Group (Ross Roofs) (the Proposed Acquisition).

Our decision

2. The Commission gives clearance to the Proposed Acquisition as it is satisfied it will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This is a merger between two of the three main suppliers of steel tiles in New Zealand, with Metalcraft being the only remaining third-party supplier of steel tiles post-acquisition. However, there has been a shift in demand away from steel tiles to long run steel over approximately the last decade, and long-run steel roofing is priced competitively with steel tiles.

4. Accordingly, for the reasons set out in detail below, we are satisfied that after the Proposed Acquisition, the merged entity would be constrained by strong existing competition. In particular, it would be constrained by manufacturers and suppliers of profiled long-run steel roofing, which we have concluded falls within the same product market as the steel tiles supplied by IKO and Ross Roofs.

Our framework

5. Our approach to analysing the competition effects of mergers is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).[1]

6. We assess mergers using the substantial lessening of competition test. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[2]

The parties

7. IKO is a Canadian roofing company that owns Roof Tile Group Limited (trading as Gerard).

8. Gerard cuts and presses steel roofing tiles from a factory in Auckland. It sells those tiles locally and into export markets.[3]

[1] Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019).
[2] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].
[3] In addition to its ownership of Gerard, IKO also sells imported asphalt shingles through local independent distributor, Techno Roofing, and imported membrane roofing and insulated panels through local independent distributor Nuralite.

9. Ross Roofs is a manufacturer and supplier of steel roofing tiles, which presses steel roofing tiles from a factory in Takanini, Auckland.

10. Ross Roofs sells its steel tiles domestically under the brand name *Metrotile*.[4]

Background to the industry

11. Gerard and Ross Roofs (the Parties) both manufacture and supply steel roofing tiles in New Zealand.

12. The Parties are the two largest manufacturers of steel roofing tiles used on residential houses in New Zealand. The only other significant domestic manufacturer of steel tiles is Metalcraft, which also manufactures long-run steel roofing.[5] Unlike the Parties, Metalcraft's steel tile products are pre-painted (ie, Metalcraft does not have a separate manufacturing line to add its own colours), and it offers a smaller range of steel tile profiles.

13. There is a wide range of roofing options available to New Zealand consumers, including steel tiles, profiled long-run steel, asphalt shingles, concrete tiles, clay tiles, membrane systems, copper tiles, cedar tiles, slate tiles, and solar tiles. A consumer's choice of roofing product will be driven by a combination of factors including:

    13.1 aesthetic preference;

    13.2 price;

    13.3 service quality (including the length and nature of the product warranty); and

    13.4 practical structural considerations.[6]

Making sales

14. Steel tiles can be supplied to customers in several different situations; specifically where a customer is:

    14.1 building a new home(s);

    14.2 re-roofing an existing home; or

    14.3 adding a roof extension to an existing home.

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4 In export markets it sells steel tiles under the brand name *Tilcor*.

5 We note that there are other smaller manufacturers of steel tiles in New Zealand (such as Apex Tile), as well as some imports of steel tiles from Korea. However, evidence received indicates that these other parties play a very small role in the New Zealand market.

6 For example: (1) Different roofing products have different minimum roof pitches (meaning that some products will not be suitable for a roof pitched too low for those products); (2) Different roofing products have different levels of suitability to areas prone to high wind, or close to the coast (where sea salt spray becomes a factor); and (3) Some roofing products (such as concrete tiles) may be sufficiently heavy that they require reinforcement to the roof substructure compared to a lightweight product like steel.

15. In each case, generally tiles are supplied by the Parties on a per-job basis (ie, installers will order the specific number of tiles required for a given job, rather than keeping their own stock of tiles).

New builds

16. For new builds, homeowners typically contract with a local builder to build their new house. The builder will discuss the homeowner's roofing product preference with the homeowner and will then often contract with a local installer of the roofing product in question to supply and install the roof. The installer will then invoice the cost of the supply and installation to the builder, who will generally pass that cost on to the homeowner.[7]

17. Where the homeowner is buying from a large Group Home Builder (GHB) they may be acquiring a building which is part of a 'pre-spec'd' package. In such cases the homeowners tend not to choose their own roofing product, because the house plans will already specify a particular product, and the GHB will already have negotiated volume discounts with a supplier of that product.

Re-roofing existing homes

18. Re-roofing projects arise when a homeowner needs to replace their existing roof. This may be, for example, because the existing roof is leaking or otherwise damaged, has reached the end of its life expectancy, or because the homeowner wishes to change the aesthetic appearance of the roof.

19. Unlike new builds, where homeowners typically contact builders in the first instance, if the scope of the work the homeowner requires is limited to a roof repair/replacement, they may be more likely to engage an installer directly.

20. Because installing different roofing products requires different expertise, an installer will generally focus on installing only one or two types of roofing product, and typically only one brand of each product. In particular, a roofing company that installs steel tiles will typically only install the steel tiles of one manufacturer.[8] As discussed below, several installers of steel tiles advised that they felt compelled to offer long-run steel in addition to steel tiles, in light of the growing consumer demand for long-run steel roofs.

21. This means that homeowners may not typically be provided with a direct, head-to-head comparison of different manufacturers' steel tiles products at the point they have selected an installer. Rather, the competition is between installers themselves, each offering to install different products and different brands.

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7 The Application at [82].

8 [ ].

Extensions to existing homes

22. As with new builds, extensions to existing homes typically require the homeowner to contract with a builder for the construction of the extended rooms.

23. Unlike new builds, however, homeowners seeking to extend an existing house may be less likely to be presented with, or to seriously consider, a wide range of roofing options. This is because the homeowner is more likely to want the roofing product used on the extended portion of the house to match the roofing product used on the existing house.[9]

Industry trends

24. Gerard submitted that profiled long-run steel is the most popular roof design in New Zealand,[10] and that "all steel tile pressers have been steadily losing share to long-run and other roofing products over the last 10 years".[11] Data supplied by Gerard indicates that long-run steel is by far the most supplied and installed roofing product in New Zealand, with an estimated 70% share of all roofing products supplied in New Zealand (compared to steel tiles' <15%).

25. This general trend was corroborated by third parties, including several installers.

    25.1 One roofing company told us that while previously there were many roofing companies that would only install steel tiles, most now also supply long-run steel. This is because customers expect more choice, and also because steel tiles have been losing share to long-run steel for around the last 10 years.[12]

    25.2 Another told us that while it previously only installed steel tiles, it feels "forced" to offer long-run steel because customers have increasingly been demanding it.[13]

    25.3 A further roofing company estimated that in Wellington, 20 years ago perhaps 80% of the houses had steel tile roofs whereas today this proportion may only be around 15-20%.[14]

26. Several possible explanations were offered for this trend.

    26.1 A number of interviewees stated that aesthetic preferences have been shifting away from steel tiles, and towards long-run steel.[15] Our inquiries

9 Commerce Commission interview with [ ].
10 The Application at [26].
11 The Application at [110].
12 Commerce Commission interview with [ ].
13 Commerce Commission interview with [ ].
14 Commerce Commission interview with [ ].
15 Commerce Commission interview with [ ], Commerce Commission interview with [ ], and Commerce Commission interview with [ ].

indicate that this is likely to be the case nationwide, although the strength of the overall trend is likely to vary between regions.

26.2 Some interviewees advised that design preferences have also been causing a shift towards latter and 'monopitched' – roofs.[16] Because long-run steel can be used on roofs with lower pitches than steel tiles,[17] the trend towards monopitched roofs favours long-run steel at the expense of steel tiles.

26.3 Other interviewees emphasised the significant marketing efforts that have been made by New Zealand Steel to promote its long-run steel product Coloursteel®.[18]

26.4 Some interviewees told us that long-run steel is easier to install than steel tiles, and that this has led to a proliferation of long-run steel installers relative to steel tile installers, making it easier for homeowners to find an installer of long-run steel than steel tiles.[19]

27. Overall, our investigations have confirmed that a combination of factors are contributing to a growing preference for long-run steel roofing at the expense of other roofing products including steel tiles.

With and without scenarios

28. With the Proposed Acquisition, the Parties' operations would be consolidated at Ross Roofs' current Takanini site, which would be upgraded to accommodate the merged entity's increased capacity.[20]

29. Without the Proposed Acquisition:

29.1 Gerard has submitted that the status quo would continue, which would involve Gerard making investments in additional capacity in a less efficient way than could be achieved through the Proposed Acquisition;[21] and

29.2 [ ].[22]

30. Based on the above, we have performed our competition analysis on the basis of a counterfactual in which Gerard and Ross Roofs continue as separate entities, which compete with each other at arms' length.

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16 Commerce Commission interview with [ ].

17 The Application at [141].

18 Commerce Commission interview with [ ].

19 Commerce Commission interview with [ ].

20 The Application at [122].

21 The Application at [125].

22 The Application at [127].

Market definition

31. The Proposed Acquisition involves the merger of the two largest steel tile manufacturers in New Zealand.

32. A substantial lessening of competition could therefore arise if the Proposed Acquisition provides the merged entity with the ability to profitably raise prices above competitive levels (or reduce quality below competitive levels) to steel tile customers. It would be able to do this if customers (or some customer groups) were not willing or able to switch to a substitutable product in the face of a price increase and/or quality decrease.

33. To determine whether this is likely we assess constraints on the merged entity in the factual and the counterfactual. Market definition is part of the framework that we use to assess the competitive constraints that would operate on the merged entity if the Proposed Acquisition proceeded.

34. We have investigated whether:

34.1 other roofing products are substitutable for steel tiles;

34.2 supply from different locations are sufficiently close substitutes to be in the same market; and/or

34.3 there are any customer groups that are likely to have a smaller range of competitive options post-merger, such that the merged entity could price discriminate against them.

Product market

What the Applicant submitted

35. The Applicant submitted that the "proposed transaction is best assessed against the market for residential roofing products in New Zealand". This market would include profiled long-run steel, pressed steel tiles, imported asphalt shingles, concrete tiles, terracotta tiles, membrane roofing systems, and 'premium' roofing products like slate, cedar shakes, solar tiles, and copper tiles.[23]

36. The Applicant submitted that while the 'premium' products identified above may be less likely to be a preferred option for some customers as a result of their costs, that "is not – in and of itself – a reason to define separate markets as a matter of fact and commercial common sense after working through the typical product, geographic and customer dimension factors".[24]

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[23] The Application at [135].

[24] The Application at [132].

37. Nevertheless, the Applicant submitted that the Proposed Acquisition would still not substantially lessen competition if the Commission defined a narrower product market that excluded premium products.[25]

The Commission's view

38. Evidence gathered over the course of our investigation indicates that long-run steel and steel tiles are substitutable for each other on the demand side and fall within the same product market.

39. First, long-run steel and steel tiles are compositionally and functionally similar.

    39.1 Both long-run steel and steel tiles are produced from the same base input (steel), supplied to manufacturers as steel coil.

    39.2 Once manufactured, both are considered to be 'lightweight steel' roofing products, with similar functional attributes. For example, both products are suitable for similar ranges of:

        39.2.1 wind conditions;

        39.2.2 other environmental conditions (such as near the ocean where corrosive salt spray is a factor); and

        39.2.3 roofing substructures.[26]

40. Second, both wholesale and installed prices for long-run steel and steel tiles are comparable between those products. In terms of installed costs, there will be slight differences in relative cost advantages depending on the type of roof being installed.[27]

41. Third, given this similarity, interviewees advised that customers switch, or threaten to switch, between steel tiles and long-run steel – including as a means of extracting better prices.

    41.1 Large GHB customers leverage the threat of moving to long-run steel in order to extract better prices for steel tiles.[28]

    41.2 Several installers that previously only installed steel tiles have told us that they now also install long-run steel because potential customers had asked

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25 The Application at [133].

26 A roof substructure that has been designed to support steel tiles will also support long-run steel, and vice versa.

27 For example, Commerce Commission interview with [ ]. We understand that simpler roof designs are likely to be particularly low-cost from a long-run perspective, whereas more complicated "hips and gables" roofs involve more measuring and cutting of long-run steel sheets, increasing the overall cost.

28 Commerce Commission interview with [ ].

them to install long-run steel, and those installers felt they would lose customers if they did not also offer long-run steel.[29]

41.3 As noted above, long-run steel is gaining sales at the expense of other roofing products including steel tiles.

42. Given the conclusions we reach below in the competitive effects section, it has not been necessary to assess whether other roofing products (such as shingles, concrete tiles, terracotta tiles, etc) are also sufficiently substitutable for steel tiles to be in the same product market.

Geographic market

43. We have considered whether supply from different locations are sufficiently close substitutes to be in the same market.

44. We understand that:

44.1 all existing suppliers of steel tiles and profiled long-run steel supply on a national basis; and

44.2 there are no regions of New Zealand where environmental factors impact the choice between steel tiles and long-run steel roofing for residential houses.[30]

45. On that basis we consider that the geographic market for the supply of steel roofing is national in scope.

Customer market

46. We have also considered whether there are any customer groups for whom long-run steel and steel tiles are not substitutable – or for whom that substitutability is diminished – such that the merged entity would be able to price discriminate against them. Based on our market inquiries, we understand that customers wanting to re-roof their homes, or build an extension to their home, may be less likely to view steel tiles and long-run steel as substitutable.

46.1 In the case of re-roofing jobs, there is some evidence suggesting that a proportion of re-roofing customers opt or a like-for-like replacement.[31] This indicates that, for those customers with steel tile roofs, once they become re-roofing customers they are less likely than new build customers to choose long-run steel.

46.2 In the case of extensions, roofing extension customers may be less likely to consider a wide range of roofing options, because the homeowner may

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29 Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

30 For example, Commerce Commission interview with [ ]; and Commerce Commission interview with [ ].

31 Commerce Commission interview with [ ].

prefer the roofing product used on the extended portion of the house to match the roofing product used on the existing house.

47. However, we have also received evidence to indicate that some re-roofing and roofing extension customers do nevertheless switch from steel tiles to long-run steel. This switching is facilitated by the following dynamics:

    47.1 A substantial majority of interviewees indicated that the cost of switching from steel tiles to long-run when re-roofing would not be materially different from undertaking a like-for-like replacement, or it could even be cheaper.[32]

    47.2 The majority of interviewees (including [ ]) advised us that customers do not need a new building consent when switching from steel tiles to long-run steel, and do not require material changes to the roof substructure.[33] A minority of interviewees indicated that switching from steel tiles to long-run steel would require a building consent, but that this was a simple, inexpensive process that was often handled by the installer directly.[34]

48. Viewed as a whole, the evidence indicates that there is some substitutability between steel tiles and long-run steel for re-roofing customers and roofing extension customers, but that this substitutability is weaker than in the case of new builds.

49. In each case, we understand that the merged entity may have the ability to identify and increase prices to re-roofing or roofing extension customers with a strong preference for steel roof tiles, because:

    49.1 the Parties [ ];[35] and

    49.2 the Parties [ ].[36]

50. We have therefore adopted separate markets for new builds, re-roofing jobs, and roofing extensions, as that will best allow us to isolate the distinct competition effects for each customer set.

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32 Commerce Commission interview with [ ]; and Commerce Commission interview with [ ]. We note that one installer who specialises in installing steel tiles informed us that the additional cost of switching to a long run roof could be around 10% to 20% higher than a like-for-like steel tile replacement, but this view was not repeated by other interviewees. Commerce Commission interview with [ ].

33 Commerce Commission interview with [ ] and Commerce Commission interview with [ ].

34 Commerce Commission interview with [ ].

35 Commerce Commission interview with Ross Roofs (23 June 2021) and customer sales data provided by IKO.

36 Commerce Commission interview with IKO (13 May 2021) and Commerce Commission interview with Ross Roof (23 June 2021).

Conclusion

51. For the reasons we have set out above, we have assessed the effect of the Proposed Acquisition on separate national markets for the supply of lightweight steel roofing products (namely steel tiles and profiled long-run steel) to:

    51.1 new builds (the New Build Market);

    51.2 re-roofing customers (the Re-roofing Market); and

    51.3 roofing extension customers (the Roofing Extension Market).

How the Proposed Acquisition could substantially lessen competition

52. We considered whether the Proposed Acquisition would be likely to substantially lessen competition in any of the relevant markets due to:

    52.1 horizontal unilateral effects (ie, whether the loss of direct competition between the Parties in the supply of steel tiles would enable the merged entity to profitably raise prices or reduce quality by itself); and

    52.2 coordinated effects (ie, whether the Proposed Acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete, or more stable).

Horizontal unilateral effects in the supply of lightweight steel roofing products

53. For the reasons set out below, we are satisfied that the Proposed Acquisition would not have, and would not be likely to have, the effect of substantially lessening competition in the markets for the supply of lightweight steel roofing products due to unilateral effects.

The New Build Market

54. In the New Build Market, we consider that the merged entity would continue to be constrained by competing suppliers of lightweight steel roofing in New Zealand.

55. Figure 1 sets out estimates of market shares in the New Build Market. This indicates the merged entity's market share would be approximately 14% and that there would not be significant aggregation in market share with the Proposed Acquisition.

Figure 1 – Market share estimates in the New Build Market[37]

Roofing material	Suppliers	Market share estimate (%)
Long-run steel	All suppliers	82.7
Steel tiles	IKO	9.0
	Ross Roofs	5.3
	Merged entity	*14.3*
	Others (including Metalcraft)	2.9
	Total	**100**

Source: Applicant's estimates based on internal data and data from BRANZ.

56. There are a number of competing suppliers of lightweight steel roofing in New Zealand that currently, and will continue to, constrain the merged entity in the New Build Market. This includes other suppliers of steel tiles and suppliers of long-run steel.

    56.1 Metalcraft: As noted above, Metalcraft is the only other significant domestic manufacturer of steel tiles in New Zealand. Its primary product in terms of output volume is long-run steel (which comprises the large majority of Metalcraft's output). [ ].[38]

    56.2 Dimond Roofing: Dimond is part of the Fletcher Steel group of companies. It has 12 roll forming branches nationwide, each of which presses steel acquired from New Zealand Steel into long-run roofing profiles.[39]

    56.3 Roofing Industries: Roofing Industries is a national roll former of long-run Colorsteel and Colorcote steel, with 13 offices from Whangarei to Cromwell. It offers approximately 13 different long-run steel profiles.[40]

    56.4 Steel & Tube: Steel & Tube is an NZX-listed long-run residential and commercial roofing supplier with a national distribution network. Steel & Tube roll forms long-run Colorsteel steel from six processing facilities in Whangarei, Auckland, Mount Maunganui, Hamilton, Wellington and Christchurch.

    56.5 Stratco: Stratco is a manufacturer and installer of long-run steel, with manufacturing and installation facilities in Rotorua, Napier, Christchurch, Cromwell, Nelson and Blenheim.

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37 The data on which the estimates in Figure 1 are based includes all sales of lightweight steel roofing products, so includes sales for re-roofing and roofing extension projects. However, these projects are a small proportion of total sales of lightweight steel roofing products. Because of this, we do not consider that the inclusion of these sales in the data materially affects the estimates set out.

38 [ ].

39 https://www.dimond.co.nz/about.

40 The Application at [31.3] and [170.4].

[ ]. Stratco historically supplied metal tiles, but [ ].

56.6 Several other smaller roll formers.

57. None of the parties we interviewed indicated that manufacturers were facing any significant capacity constraints impacting on their ability to expand in the New Build Market.[41]

58. Feedback we received during our investigation indicates that competitors would constrain the merged entity post-acquisition in the New Build Market. In particular, several interviewees expressed the view that the merged entity would be unable to profitably raise prices of steel tiles in the New Build Market because if it did, it would lose sales to long-run steel suppliers. For example:

58.1 one installer advised that the Proposed Acquisition would be unlikely to affect the price of tiles, because the merged entity would still need to be competitive against long-run;[42]

58.2 another installer stated that the market is price-driven, and that if the merged entity increased prices customers would react, and the roofing company would "just pick up more long-run";[43] and

58.3 an installer told us that the merged entity would "price itself out of the market" if it imposed a SSNIP, because customers would switch to long-run steel.[44]

59. Given that the prevailing aesthetic roofing material trends appear to be moving away from steel tiles, and towards long-run steel, we consider that existing competitors are well-placed to continue to exert competitive constraint on the merged entity in the New Build Market.

The Re-roofing Market

60. In the Re-roofing Market, we consider that the merged entity would continue to be constrained by competing suppliers of lightweight steel roofing in New Zealand, including in its ability to profitably raise prices.

61. As noted earlier, the extent of substitutability between steel tiles and long-run steel is likely to be lesser for re-roofing customers than for new build customers, because the former is likely to be more strongly inclined to stick to their existing roofing product when re-roofing.

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[41] Commerce Commission interview with [ ], Commerce Commission interview with [ ] and Commerce Commission interview with [ ].

[42] Commerce Commission interview with [ ].

[43] Commerce Commission interview with [ ].

[44] Commerce Commission interview with [ ].

62. However, we are satisfied that even if the merged entity has some ability to price discriminate against re-roofing customers that do not wish to switch from steel tiles to long-run steel, it is unlikely to have a sufficient incentive to do so, because:

    62.1 the number of re-roofing customers per year with existing steel tile roofs (ie, the set of customers against which the merged entity could conceivably price discriminate) is small; and

    62.2 our interviews with third parties indicate that switching between steel tiles and long-run steel – while less frequent than in the case of new builds – still occurs, and would therefore reduce the potential profitability of any price discrimination strategy.

63. We also received no information to suggest that estimated market shares, the number of competitors, or the constraints impacting on the ability of competitors to expand in the Re-roofing Market materially differed to that in the New Build Market.

The Roofing Extension Market

64. For the same reasons as set out above with respect to the Re-roofing Market, in the Roofing Extension Market, we consider that the merged entity would continue to be constrained by competing suppliers of lightweight steel roofing in New Zealand, including in its ability to profitably raise prices.

Coordinated effects in the supply of lightweight steel roofing products

65. We considered whether the Proposed Acquisition would change the conditions in the markets for the supply of lightweight steel roofing products so that coordination is more likely, more complete, or more stable.

66. We concluded above that the market for the supply of lightweight steel roofing products includes both steel tiles and profiled long-run steel. On that basis, the merged entity will compete not only with other steel tile suppliers, but also with a number of suppliers of long-run steel roofing.

67. We do not consider that the Proposed Acquisition will materially increase the risk of coordination in supply of lightweight steel roofing products, because:

    67.1 post-acquisition there would be a material number of remaining suppliers; and

    67.2 market participants are of different sizes and cost structures, and vary in the extent to which they are vertically integrated into distribution/installation; and

    67.3 we understand that there is minimal price transparency. In particular, while suppliers may begin with base 'list prices' to installers, these list prices are frequently subject to additional discounts (including but not limited to volume discounts) which are negotiated individually with each installer.

Overall conclusion

68. Post-acquisition, we consider that the merged entity will continue to be constrained by the existing competition in the markets for the supply of lightweight steel roofing products.

69. We are therefore satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Determination on notice of clearance

70. Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to IKO Industries Limited to acquire all of the shares of Ross Roof Group.

Dated this 29th day of June 2021

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Anna Rawlings
Chair