

Part II

Background and evidence

3 The companies and the merger situation

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Introduction

3.1. This chapter begins with details of the proposed merger and of the Business Sale Agreement between Rockwool and OCBP. This is followed by a description of each of the companies involved in the merger situation, including their history, business, group structure, financial and operational performance and future prospects. Rockwool provided us with details of its projections of a combination of its business with the OCBP stone wool business and of its financial case for the acquisition; an account of this is given, together with details of the proposed future trading relationship between Rockwool and OCBP. Finally an indication is given of the plans of OCBP should the combination of the two businesses not proceed.

The merger situation

3.2. Under an agreement dated 30 September 1998 (the Business Sale Agreement) Rockwool agreed to purchase the stone wool manufacturing business of OCBP, which is based at Queensferry in North Wales, for a consideration of £[∞] million. The Business Sale Agreement is conditional on

regulatory clearance and it provides that Rockwool is entitled to treat the agreement as terminated unless one of the three following conditions is fulfilled or the conditions are waived by Rockwool:

- (a) confirmation from the OFT that the acquisition of the stone wool business of OCBP does not qualify for investigation by the Commission under the merger provisions of the Act; or
- (b) the Secretary of State confirms that he does not intend to refer any aspect of the acquisition to the Commission for investigation and report under the Act without requiring any amendments, assurances or undertakings of Rockwool that are not accepted by that company at its sole discretion; or
- (c) following a referral to and report by the Commission, confirmation from the Secretary of State that the acquisition may proceed without requiring any amendments, assurances or undertakings of Rockwool that are not accepted by that company at its sole discretion.

The Business Sale Agreement calls for OCBP and Rockwool to use all reasonable endeavours to fulfil or procure the fulfilment of the conditions set out above as soon as possible after the date of the agreement, but Rockwool is able either to waive the conditions or to extend the period in which the conditions are to be satisfied up to but not beyond 30 April 1999.

3.3. The stone wool manufacturing business forms part only of the business of OCBP (see paragraph 3.24); accordingly the Business Sale Agreement covers the business assets as a going concern including the property, plant and machinery, intellectual property, know-how, stock, trade names and trade marks. Certain property is excluded from the scope of the Business Sale Agreement such as cash, receivables, trade payables, some equipment, finished goods acquired by OCBP from particular third parties and sundry liabilities including taxation liabilities. OCBP, previously called Pilkington Insulation, had been acquired by its present owner (Owens Corning of the USA; in this report Owens Corning is used to refer both to the parent company and to the group) in 1994. As the result of a review in the course of 1997 and 1998 the parent company decided to divest certain non-core and underperforming assets as part of a global restructuring programme. A press release on 5 October 1998 from Owens Corning said that its aim in the sale of the business was to enable the UK group to focus on its core insulation businesses of glass wool and extruded polystyrene and to generate cash for investment. On the same date a press release from Rockwool referred to the company's strong brand name being enhanced in the eyes of specifiers and customers by the acquisition.

3.4. When the board of Owens Corning decided to dispose of the stone wool manufacturing business of OCBP, a leading firm of UK investment bankers, Flemings, was appointed in December 1997 to handle the transaction. A number of potential purchasers were approached, including the Finnish group Partek and two US companies, but substantive negotiations took place only between Flemings, acting on behalf of OCBP, and Rockwool. The initial asking price on the part of Owens Corning was £[] million. Following an initial indicative offer of £[] million from Rockwool, a figure of £[] million was accepted by the two parties as the starting point for negotiations and for due diligence. Reductions of around £[] million for exceptions to the 'non-compete' covenants (see paragraph 3.5) and £[] million for environmental requirements were made and a number of other factors were taken into account in reaching the agreed price of £[] million. (Quantification of the factors involved in the price negotiations is on an indicative basis only as Rockwool stressed that it was not possible to assign an exact value to each factor in the negotiations.)

3.5. The Business Sale Agreement included restrictions on the business activities of OCBP (the 'non-compete' covenants). OCBP undertook not to engage in the business of manufacturing stone wool in the UK for a period of five years, and for a period of four years not to sell or market stone wool to its then UK customers, subject to a number of exceptions under which OCBP would be able to market certain stone wool products to identified customers. There are two main elements to the arrangements. First, OCBP would be able to continue to supply existing customers with imported products from Partek and Icerock (see paragraph 3.6) and to supply some other customers (known as 'compete' customers) with a broader range of stone wool products. Secondly, a Supply Agreement has been drafted between the companies, but not yet entered into, under which Rockwool would supply five specified stone wool products (or groups of products) to OCBP for a period of four years, with OCBP being required to purchase a minimum of 3,000 tonnes a year. This figure could be reduced under certain circumstances: first, if OCBP purchased the same products from other manufacturers on more

favourable terms than those provided for under the agreement with Rockwool and which Rockwool elected not to match; and secondly, if Rockwool was unable to supply any of the products and OCBP purchased them instead from another source. A summary of the Supply Agreement is contained in Appendix 3.1.

3.6. We asked Owens Corning why it had not conducted an auction for the sale of the Queensferry business. The company said that there were reasons to expect Rockwool to offer the best price, including the opportunity for Rockwool to expand its production capacity at a lower cost than by building a new line at its existing Bridgend plant and potential synergies in production and delivery costs. [

Details omitted. See note on page iv.

]. Two other mineral wool manufacturers, [*Details omitted. See note on page iv.*], were not considered to be in a position to achieve the same synergies as Rockwool and were therefore unlikely to make an offer in the range that Owens Corning considered acceptable. [

Details omitted. See note on page iv.

] had later expressed an interest, but by that stage OCBP was in negotiations with Rockwool and it decided not to risk delaying agreement on a sale. A paper submitted for an Owens Corning board meeting in June 1998 stated that 'for strategic and other considerations Owens Corning has decided to sell the Queensferry business to Rockwool International' which was the 'key strategic buyer for this business in the UK'.

3.7. An English translation of the minutes of a Rockwool International board meeting in January 1998 recorded that 'The advantages by acquiring the factory seem to be that we will lack capacity in the future, we will take a competitor out of the market and the factory could be used for production of special products with [Rockwool's Bridgend] factory concentrating on main products.' A later board meeting, in April 1998, noted the scope for expansion of capacity at Queensferry at a cost of £[§] million to £[§] million and the potential for cost savings of a similar amount. In addition the minutes stated that 'An acquisition of the Queensferry plant could postpone the building of a line 3 in [Bridgend] for 2-3 years and prevent somebody from penetrating the stone wool market for some years'; and also that Owens Corning 'has asked for a very high price of approximately [DKK][§] million and in this connection openly referred to the fact that we are getting a premium for being the only stone wool producer on the market and they want a part of this premium'.

Rockwool

Outline of the Rockwool group

3.8. The Rockwool group, which was founded in 1937, is the world's largest manufacturer of stone wool. It has 17 factories in nine countries in Europe and North America, together with a network of supply companies and distributors throughout the world. The group has more than 6,000 employees. The parent company, Rockwool International, is incorporated in Denmark and has its headquarters at Hedehusene, near Copenhagen. The equity shares of Rockwool International are listed on the Copenhagen Stock Exchange and the market capitalization at 31 December 1998 was DKK4,560 million (£429 million¹). In the year to 31 December 1997 the group turnover was DKK6,258 million (£588 million) and the pre-tax profit was DKK495 million (£47 million). At 31 December 1997 the group had total assets of DKK5,604 million (£527 million) and shareholders' funds of DKK3,167 million (£298 million). Rockwool is a wholly-owned subsidiary of Rockwool International.

¹Unless stated otherwise, amounts in Danish kroner are converted to sterling at the closing rate on 31 December 1998 of £1:DKK 10.6355.

History, business and current group structure

3.9. The Rockwool group divides its business into two categories, the insulation business and the systems division. The insulation business is managed as two divisions. The northern division comprises subsidiary companies in Denmark, Norway, Sweden and the UK together with sales offices in Lithuania and Russia. The continental division comprises subsidiary companies in Germany, Austria, the Czech Republic, Hungary, the Netherlands, Belgium, France, Italy, Spain, Poland and Canada, as well as sales offices in Slovakia and the Ukraine. The systems division markets stone-wool-based acoustic ceilings, horticultural substrates for flowers and vegetables, technical fibres, facade cladding boards and noise-absorbing boards for outdoor applications.

3.10. Rockwool thus forms part of the northern division of the insulation business. The company was incorporated in 1970 and in 1978 it became jointly owned by Rockwool Investments Ltd (Rockwool Investments, a UK subsidiary of Rockwool International) and British Petroleum plc (BP). The UK factory and head office were established at Bridgend, South Wales, in 1979 with the commissioning of one production line for the manufacture of stone wool. In 1980 a second production line was established on the same site. In recent years the maximum capacity of the two lines has been reduced as a result of environmental constraints, a change in the mix of the materials used and an increased concentration on quality of output. The 1998 capacity was 84,000 tonnes, some way below the 1994 capacity of 97,000 tonnes. Actual output in 1998 was 78,500 tonnes, which represented a 93 per cent use of capacity. The Bridgend site currently employs approximately 450 people. In 1986 BP sold its shares in Rockwool to Rockwool International and in 1989 these shares were transferred to Rockwool Investments, so that Rockwool then became a wholly-owned subsidiary of Rockwool Investments. Apart from Rockwool Investments and Rockwool, there are three other UK companies owned by Rockwool International: Rockwool Trustees Limited, which does not trade but has the business of administering the group pension scheme; Energysaver Limited, which is dormant; and Rockfon Limited, which is part of the systems division of Rockwool International and supplies suspended ceilings and acoustic materials.

Financial summary

Rockwool International A/S

3.11. The results of the Rockwool International group for the five years to 31 December 1997 are shown in Table 3.1. Over the period from 1993 to 1997 net sales increased by 30 per cent from DKK4,799 million to DKK 6,258 million. Operating profit before financial items rose by 22 per cent from DKK353 million to DKK434 million, though both the 1995 and 1996 profits were below the 1994 level of DKK417 million.

TABLE 3.1 **Rockwool International: financial results,1993 to 1997**

DKK million

| | <i>Years ended 31 December</i> | | | | |
|--|--------------------------------|-------------|--------------|--------------|--------------|
| | 1993 | 1994 | 1995 | 1996 | 1997 |
| Net sales | 4,799 | 5,088 | 5,335 | 5,719 | 6,258 |
| Operating profit before financial items | 353 | 417 | 316 | 371 | 434 |
| Financial items* | <u>7</u> | <u>(34)</u> | <u>67</u> | <u>87</u> | <u>61</u> |
| Profit before tax | 360 | 383 | 383 | 458 | 495 |
| Taxation | <u>(114)</u> | <u>(97)</u> | <u>(128)</u> | <u>(120)</u> | <u>(150)</u> |
| Profit after tax | 246 | 286 | 255 | 338 | 345 |
| Minority interest | <u>-</u> | <u>(2)</u> | <u>(3)</u> | <u>(5)</u> | <u>-</u> |
| Profit for the year | 246 | 284 | 252 | 333 | 345 |
| Dividends | <u>(26)</u> | <u>(26)</u> | <u>(39)</u> | <u>(44)</u> | <u>(48)</u> |
| Retained profit | 220 | 258 | 213 | 289 | 297 |
| Cash flow (profit after tax plus depreciation) | 706 | 726 | 695 | 852 | 875 |
| Operating profit margin (%) | 7.4 | 8.2 | 5.9 | 6.5 | 6.9 |
| Return on average shareholders' funds (%) | 12.4 | 12.4 | 10.1 | 12.3 | 11.5 |

Source: Rockwool International.

*Interest receivable, less interest payable.

3.12. A summary of the balance sheets of the Rockwool International group for each of the last five years is given in Appendix 3.2.

Rockwool Limited

3.13. The results of Rockwool for the five years to 31 December 1997 are shown in Table 3.2. Turnover increased by 26 per cent from £43.7 million in 1993 to £54.9 million in 1996, but then fell by 7 per cent to £51.2 million in 1997. Operating profit rose by 122 per cent from £2.2 million to £4.8 million between 1993 and 1996, but then fell by 77 per cent to £1.1 million in 1997 before rising again in 1998 (see paragraph 3.15 and Appendix 3.4). Rockwool told us that it attributed the downturn in 1997 to a decrease in general building activity and the postponement of major projects, both industrial and general building.

TABLE 3.2 **Rockwool: financial results, 1993 to 1997**

| | Years ended 31 December | | | | | £'000 |
|--|-------------------------|----------|----------|----------|----------|-------|
| | 1993 | 1994 | 1995 | 1996 | 1997 | |
| Turnover | 43,713 | 46,002 | 49,916 | 54,928 | 51,198 | |
| Cost of sales | (30,006) | (30,048) | (32,564) | (35,217) | (34,670) | |
| Gross profit | 13,707 | 15,954 | 17,352 | 19,711 | 16,528 | |
| Distribution costs and administrative expenses | (11,530) | (12,771) | (13,977) | (14,870) | (15,406) | |
| Operating profit | 2,177 | 3,183 | 3,375 | 4,841 | 1,122 | |
| Interest receivable/(payable) | (326) | (231) | 27 | 1 | 27 | |
| Profit before tax | 1,851 | 2,952 | 3,402 | 4,842 | 1,149 | |
| Taxation | (497) | (932) | (828) | (1,448) | (188) | |
| Profit after tax | 1,354 | 2,020 | 2,574 | 3,394 | 961 | |
| Dividends | (1,469) | (2,020) | (2,574) | (3,094) | - | |
| Retained profit | (115) | - | - | 300 | 961 | |
| Cash flow (profit after tax plus depreciation) | 4,130 | 4,883 | 5,495 | 6,651 | 4,492 | |
| Fixed asset investment | (2,394) | (1,765) | (3,022) | (4,062) | (3,880) | |
| Depreciation (net of grants) | 2,776 | 2,863 | 2,921 | 3,257 | 3,531 | |
| Operating profit margin (%) | 5.0 | 6.9 | 6.8 | 8.8 | 2.2 | |
| Return on average shareholders' funds (%) | 9.2 | 13.7 | 17.5 | 22.9 | 6.2 | |

Source: Rockwool.

3.14. A summary of the balance sheets of Rockwool for each of the five years to 31 December 1997 is shown in Appendix 3.3. At 31 December 1997 shareholders' funds totalled £16.0 million; there were fixed assets of £14.0 million and cash (less borrowings) of £2.1 million.

Operational performance

3.15. The results of Rockwool as shown by its management accounts for the five years to 31 December 1998 are shown in Appendix 3.4. The details in Appendix 3.4 indicate the extent of the downturn in profit in 1997 and the partial recovery in 1998. The results shown by the management accounts do not precisely coincide with the statutory accounts, details of which are shown in Table 3.2, because of amendments made after the year end in the course of preparing the statutory accounts.

3.16. During the period from 1994 to 1998, haulage costs for delivery of stone wool products from Bridgend to customers accounted for some [\approx] per cent of invoiced sales. In 1997 and 1998 the freight costs for imported products were [\approx] per cent and [\approx] per cent of invoiced sales respectively. These amounts are not directly comparable with the average haulage cost for delivery from Bridgend as the type of products imported normally differs substantially from the product mix of own manufactured goods (see paragraphs 4.68 to 4.81).

3.17. Rockwool supplied us with an analysis of the gross and net profit of different business segments, details of which for 1998 are shown in Table 3.3. In 1997 the three segments used by Rockwool for its analysis were structural (including roofing, general building, fire protection, OEM, external wall, part of slab and Rocktherm), retail (including granulate and Rockclad) and industrial (comprising both offshore sales and other industrial sales, as well as part of common slab). In 1998 the segments used for analysis were changed to building (general building, fire protection, part of common slab, retail and granulate), systems products (roofing, OEM, Rocktherm, external wall and Rockclad) and industrial (which covered the same products as in 1997).

TABLE 3.3 **Rockwool: analysis of sales, contribution and net profit by business segment, 1998**

| | <i>Building</i> | <i>Systems</i> | <i>Industrial</i> | <i>Total</i> |
|---------------------------------------|--|----------------|-------------------|--------------|
| Quantity sold ('000 tonnes) | 49.2 | 13.8 | 15.9 | 78.9 |
| | <i>£ million</i> | | | |
| Invoiced sales | 26.2 | 9.9 | 17.8 | 53.9 |
| Sales net of rebates | <div style="display: flex; align-items: center; justify-content: center;"> { <div style="text-align: center;"> <i>Figures omitted. See note on page iv.</i> </div> } </div> | | | |
| Contribution | | | | |
| Net profit before extraordinary items | | | | |
| | | | | |
| | <i>per cent</i> | | | |
| <i>Per cent of total</i> | | | | |
| Quantity sold | 62.3 | 17.5 | 20.2 | 100.0 |
| Invoiced sales | 48.6 | 18.4 | 33.0 | 100.0 |
| Sales net of rebates | 48.8 | 20.3 | 30.9 | 100.0 |
| Contribution | 45.0 | 22.8 | 32.2 | 100.0 |
| Net profit before extraordinary items | 32.1 | 25.0 | 42.9 | 100.0 |

Source: Rockwool.

As industrial products tend to be of higher value than structural products, they accounted for 20 per cent of the quantity sold in 1998 but generated 33 per cent of invoiced sales. The contribution of all three business segments was closely aligned with sales value, but at the net profit level industrial products accounted for 43 per cent. Rockwool told us that the relative profitability of business segments varied year by year. Over the four years 1995 to 1998, the industrial segment averaged 30 per cent of sales net of rebates and 33 per cent of net profit, while over the same period the return of the industrial segment (net profit as a percentage of sales net of rebates) averaged 5.6 per cent compared with 7.3 per cent for the structural segment. However, in the years 1997 and 1998 the industrial segment averaged 30 per cent of sales and 50 per cent of net profit, while its average return on sales of 7.3 per cent was above that of the structural segment at 3.4 per cent.

Future prospects

3.18. Rockwool provided us with details of a business plan drawn up in September 1998 showing projections for the company with and without the acquisition of the Queensferry business from OCBP. Details of the 'without acquisition' business plan are summarized in Table 3.4. The comparable projections including the acquisition of the Queensferry plant are considered in paragraphs 3.36 to 3.41 (including Table 3.7). Rockwool calculated that, discounted at 10 per cent, the present value of the post-tax cash flows to 2004 (including £[30] million for 1998) would be £[30] million and the total (including 2005 and thereafter) would be £[30] million.

TABLE 3.4 **Rockwool: business plan without the acquisition of the Queensferry business**

| | Years to 31 December | | | | | | £ million |
|--|----------------------|------|------|------|------|------|-----------|
| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Quantity sold ('000 tonnes) | | | | | | | |
| Invoiced sales | | | | | | | |
| Net sales ex works | | | | | | | |
| Contribution ratio (%)*† | | | | | | | |
| Profit before interest and depreciation | | | | | | | |
| Profit before tax | | | | | | | |
| Profit before tax ratio (%)* | | | | | | | |
| Profit after tax | | | | | | | |
| Cash flow from operations (profit after tax plus depreciation) | | | | | | | |
| Investment in fixed assets | | | | | | | |
| Cash flow | | | | | | | |
| Present value after discounting @ 10% | | | | | | | |

Figures omitted. See note on page iv.

Source: Rockwool.

*The contribution and profit before tax ratios are calculated by Rockwool on the net sales ex works.

†The falling contribution ratio reflects in part the rising volume of sales of imported products which carry lower gross margins. Imports are projected to increase from [] tonnes in 1999 to [] tonnes by 2005.

3.19. The main underlying assumptions for the business plan (which was in nominal prices) were that the growth in quantity sold would be [] per cent a year; that prices of both own-produced goods and imported goods would rise by 1 per cent a year; that variable production costs would rise by [] per cent a year from 1999 onwards, based on an annual increase of [] per cent in the price of inputs partly compensated by cost savings of [] per cent a year; and that fixed costs would rise by [] per cent a year. The business plan showed continuation of the recovery in 1998 with pre-tax profit peaking in 2002 at £[] million [Details omitted. See note on page iv.] but declining thereafter to £[] million in 2005.

3.20. Output at Bridgend was set at 81,000 tonnes, so the increase in quantity sold was assumed to be met by imports. At an earlier stage Rockwool was planning the construction of a third line at Bridgend at a cost of £30 million to £35 million (for which planning consent had been received) in order to increase capacity. Plans for this had been suspended when negotiations for the purchase of Queensferry commenced.

Owens Corning

Outline of the Owens Corning group

3.21. The Owens Corning group, founded in 1938, supplies consumers and industrial customers with building materials systems and high-performance glass composites. The parent company, Owens Corning, is incorporated in Delaware and has its headquarters at Toledo, Ohio. Its equity shares are listed on the New York Stock Exchange and the market capitalization at 31 December 1998 was \$1,922 million (£1,150 million¹). The group employs more than 20,000 people in 30 countries worldwide. In the year to 31 December 1997 the group turnover was \$4,373 million (£2,617 million) and the pre-tax profit was \$71 million (£42 million). At 31 December 1997 the group had total assets of \$4,996 million (£2,990 million), including tangible fixed assets of \$1,753 million (£1,049 million),

¹Unless stated otherwise, amounts in US dollars are converted to sterling at the closing rate on 31 December 1998 of £1:\$1.6708.

and a deficit of equity shareholders' funds of \$441 million (£264 million). OCBP is a wholly-owned subsidiary of Owens Corning.

History, business and current group structure

3.22. Owens Corning was originally formed as an equal-partner joint venture between the Owens-Illinois Glass Company of Toledo, Ohio, and Corning Glass Works of Corning, New York, to manufacture fibreglass insulation and furnace filters. The company was a pioneer of glass fiberization and developed glass fibre materials as reinforcements for plastics. Today the group's products are used in industries such as home improvement, building construction, transportation, marine, aerospace, energy appliances and electronics. In the early 1950s a US anti-trust decree required partial divestment of their shareholdings by the original partners and the company later obtained a stock exchange listing.

3.23. Owens Corning was previously known as Owens-Corning Fiberglas Corporation,¹ but the name was changed to Owens Corning in 1995. The group operates in two industry segments for the purpose of external reporting: building materials and composite materials. In 1997 the building materials segment accounted for 74 per cent of group sales, whilst composite materials accounted for the remaining 26 per cent. In 1994 Owens Corning embarked on a growth strategy primarily focused on building materials products in both North America and Europe. European acquisitions included OCBP (glass wool and stone wool), Lincpac (extruded polystyrene foam in the UK and Spain) and Polypan (extruded polystyrene foam in Italy). However, the extent of the European operations remained modest in relation to those in North America. In the year to 31 December 1997 European sales accounted for some 16 per cent of Owens Corning group sales; 43 per cent of European sales were building materials and 57 per cent were composite materials. More recent ventures by Owens Corning have been the construction in 1996 of glass wool and extruded polystyrene plants on greenfield sites in China, entering the South African market with the 1996 acquisition of Acoustical Fibreglass Insulation and the acquisition in 1997 of Fibreboard Corporation and AmeriMark Building Products, both of which supply vinyl siding and accessories to the North American market.

3.24. In 1994 Owens Corning acquired two companies from Pilkington, Pilkington Insulation (following which the name of the company was changed to OCBP) and Kitson's. OCBP has two factories manufacturing glass wool and one, Queensferry, manufacturing stone wool. In 1995, the first full year after the acquisition, the glass wool business accounted for 80 per cent of OCBP's sales and the stone wool business for 20 per cent; the relative size of the two businesses remained the same in 1998. In the year to 31 December 1998 the capacity of the Queensferry plant was some 23,000 tonnes and output was 20,920 tonnes, to give a 91 per cent use of capacity. Kitson's is a distributor of thermal, acoustic, safety and fire protection materials and is a major customer of OCBP. In the course of 1997 and 1998 Owens Corning decided to divest certain non-core and underperforming assets as part of a global restructuring programme. In the UK, Kitson's and the Queensferry plant of OCBP were identified for sale as neither was performing in line with the Owens Corning internal benchmark for required rate of return on shareholders' funds. Kitson's was sold to SIG in July 1998 and the Business Sale Agreement for the Queensferry plant was signed in September 1998 (paragraph 3.2).

3.25. There are currently nine Owens Corning group companies in the UK, all of which are wholly owned, as follows:

| | |
|--------------------------------------|--|
| Owens-Corning UK Holdings Limited | Holding company |
| Owens Corning Polyfoam UK Limited | Sale of thermal insulation material and related products |
| Owens-Corning Fiberglas (UK) Limited | Sub holding company |
| Owens Corning Fiberglas (GB) Ltd | Manufacture and sale of glass fibre and similar material |
| Owens-Corning Veil UK Ltd | Manufacture and sale of glass fibre tissue |

¹The use of a hyphen in the Owens Corning name differs between companies in the group. The original name of Owens-Corning Fiberglas Corporation included a hyphen, but it is omitted in the present Owens Corning name. In the UK, five companies, including OCBP, have a hyphen in their name, while three do not.

| | |
|--|---|
| Owens-Corning Building Products (UK) Limited | Manufacture, processing and sale of stone wool and glass wool insulation products |
| Owens-Corning Finance (UK) PLC | Provision of finance for the Owens Corning group in the UK |
| Scanglas Ltd | Dormant |
| Wrexham AR Glass Ltd | Dormant |

A tenth company, Owens Corning Fibreglas (UK) Pension Plan Ltd, is jointly owned by Owens-Corning Fibreglas (GB) Ltd and Owens-Corning Veil UK Ltd.

Financial summary

Owens Corning

3.26. The results of the Owens Corning group for the five years to 31 December 1997 are shown in Table 3.5.

TABLE 3.5 **Owens Corning: financial results, 1993 to 1997**

| | <i>\$ million</i> | | | | |
|---|--------------------------------|-------------|--------------|-------------|--------------|
| | <i>Years ended 31 December</i> | | | | |
| | 1993 | 1994 | 1995 | 1996 | 1997 |
| Net sales | 2,944 | 3,351 | 3,612 | 3,832 | 4,373 |
| Operating profit before cost of borrowed funds | 236 | 226 | 420 | (491)* | 182 |
| Cost of borrowed funds | <u>(89)</u> | <u>(94)</u> | <u>(87)</u> | <u>(77)</u> | <u>(111)</u> |
| Profit before tax | 147 | 32 | 333 | (568) | 71 |
| Taxation | <u>(47)</u> | <u>(58)</u> | <u>(109)</u> | <u>283</u> | <u>(9)</u> |
| Profit after tax | 100 | 74 | 224 | (285) | 62 |
| Minority interest | - | - | (5) | (8) | (11) |
| Net income of affiliates | 5 | - | 12 | 9 | 11 |
| Cumulative effect of accounting change | <u>26</u> | <u>85</u> | <u>-</u> | <u>-</u> | <u>(15)</u> |
| Profit for the year | 131 | 159 | 231 | (284) | 47 |
| Dividends | <u>-</u> | <u>-</u> | <u>-</u> | <u>(7)</u> | <u>(16)</u> |
| Retained profit | 131 | 159 | 231 | (291) | 31 |
| Cash flow from operations (including changes in working capital and provisions) | 253 | 233 | 285 | 335 | 131 |
| Operating profit margin (%) | 8.0 | 6.7 | 11.6 | (12.8) | 4.2 |

Source: Owens Corning.

*The operating profit for 1996 was arrived at after making a further provision for asbestos litigation claims of \$875 million (\$542 million after tax). In 1991 a similar provision of \$824 million (\$542 million after tax) had been made.

3.27. A summary of the balance sheets of the Owens Corning group for each of the last five years is given in Appendix 3.5.

Owens-Corning Building Products (UK) Limited

3.28. Following the acquisition of Pilkington Insulation by Owens Corning in June 1994, the year-end of the company was changed from 31 March to 31 December. The results of OCBP for the four years and nine months to 31 December 1997 are shown in Table 3.6.

TABLE 3.6 OCBP: financial results, 1 April 1993 to 31 December 1997

| | £'000 | | | | |
|------------------------------------|----------------------|--------------------------------|--------------------------------|-----------------|-----------------|
| | <i>Periods ended</i> | | <i>Years ended 31 December</i> | | |
| | <i>31.3.94</i> | <i>31.12.94 (9 months)</i> | <i>1995</i> | <i>1996</i> | <i>1997</i> |
| Turnover | 63,483 | 51,612 | 72,919 | 71,890 | 73,744 |
| Cost of sales | <u>(50,815)</u> | <u>(34,522)</u> | <u>(52,717)</u> | <u>(53,982)</u> | <u>(58,099)</u> |
| Gross profit | 12,668 | 17,090 | 20,202 | 17,908 | 15,645 |
| Other operating expenses | <u>(8,951)</u> | <u>(8,848)</u> | <u>(12,049)</u> | <u>(14,429)</u> | <u>(15,352)</u> |
| Operating profit | 3,717 | 8,242 | 8,153 | 3,479 | 293 |
| Interest payable | (1,591) | (727) | (1,033) | (1,351) | (1,330) |
| Reorganization costs* | - | <u>(11,749)</u> | <u>(5,030)</u> | - | - |
| Profit before tax | 2,126 | (4,234) | 2,090 | 2,128 | (1,037) |
| Taxation | <u>(1,602)</u> | <u>(505)</u> | <u>935</u> | <u>(7,498)†</u> | <u>695</u> |
| Profit after tax | 524 | (4,739) | 3,025 | (5,370) | (342) |
| Dividends | - | - | - | - | - |
| Retained profit | <u>524</u> | <u>(4,739)</u> | <u>3,025</u> | <u>(5,370)</u> | <u>(342)</u> |
| Funds flows: | | | | | |
| Operating profit plus depreciation | 8,750 | 11,049 | 12,300 | 7,695 | 4,757 |
| Profit after tax plus depreciation | 5,557 | (1,932) | 7,172 | (1,154) | 4,122 |
| Fixed asset investment | (1,499) | (7,398) | (7,919) | (4,739) | (7,769) |
| Depreciation | 5,033 | 2,807 | 4,147 | 4,216 | 4,464 |
| Operating profit margin (%) | 5.9 | 16.0 | 11.2 | 4.8 | 0.4 |

Source: OCBP.

*There were further reorganization costs in 1997 of £2.6 million which were included in other operating expenses.

†There was a £6.8 million prior year deferred tax charge in 1996 in order to recognize the potential liability arising from timing differences resulting from capital allowances received for tax purposes in earlier years.

3.29. A summary of the balance sheets of OCBP at 31 March 1994 and at 31 December 1994 to 1997 is shown in Appendix 3.6. At 31 December 1997 shareholders' funds totalled £23.6 million and there were tangible fixed assets of £46.9 million. The net debt was £13.8 million, which gave rise to a gearing (debt:debt plus equity) of 37 per cent.

Operational performance

3.30. Separate management accounts are prepared for the glass wool and stone wool businesses of OCBP. A summary of these management accounts for the four years to 31 December 1998 is shown in Appendix 3.7.

3.31. Appendix 3.7 indicates that the glass wool business has been consistently more profitable than the stone wool business. The turnover figures of OCBP for the years 1995 to 1997 in Appendix 3.7 are comparable with those in Table 3.6 but there is a considerable difference at the net profit level. The main reason for the difference is that the OCBP management accounts are prepared using US generally accepted accounting principles (GAAP), while the statutory accounts on which Table 3.6 is based are prepared using UK GAAP. OCBP reconciles the two sets of accounts and details of the reconciliation for the years 1995 to 1997 are shown in Appendix 3.8. The largest differences arose in connection with the amortization of goodwill, different treatments for the capitalization of costs under US and UK accounting principles, pension costs and accruals for restructuring costs.

3.32. For the management accounts shown in Appendix 3.7, OCBP allocated operating expenses between the glass wool and stone wool businesses pro rata to turnover in the absence of sufficiently detailed information on the cost drivers. With the exception of £0.1 million of goodwill amortization, the overhead expenses, which are excluded in arriving at the controllable income from operations, have been allocated to the glass wool business. Most of these overhead expenses are charges between companies within the Owens Corning group and would not necessarily be identical with costs incurred by an independent business.

3.33. OCBP has provided us with estimated pro forma statements of net assets for the Queensferry factory as an indication of the resources employed there; these are shown in Appendix 3.9. Estimated net tangible assets at Queensferry at 31 December 1998 were £[] million, including fixed assets of £[] million (net of the government grant of £[] million).

3.34. The grant shown in Appendix 3.9 was provided by the Welsh Office in connection with investment at the Queensferry site and carries with it a commitment to safeguard 110 permanent jobs. We have been told that the intention of the two parties to the Business Sale Agreement is for Rockwool to accept novation of the commitments on employment, subject to agreement from the Welsh Office. The undertakings will in any case lapse in January 2000, 18 months after the final claim was paid. Current employment at the Queensferry site is around 115 people, though some support and management staff at other OCBP sites work substantially on Queensferry business.

Future prospects

3.35. OCBP provided us with a copy of its long-range business plan for the years 1997 to 2002 which had been prepared in May 1997, before the decision was taken to dispose of the Queensferry business. The stone wool business was not differentiated from the main glass wool business; the company told us that a major assumption for Queensferry had been that expenditure should be limited to essential maintenance and meeting statutory requirements on safety and the environment. OCBP also provided a copy of the current projection for 1999 showing the position with the exclusion of the stone wool manufacturing business. OCBP told us that it had not prepared an alternative projection with retention of Queensferry as it had expected the sale to Rockwool to be completed. The marketing plan for industrial products for 1999 discussed the approach to the market together with proposals to sell glass wool insulation for applications in temperature ranges up to 540°C which had previously been supplied by stone wool products, but there was no quantification in either sales tonnage or in financial terms. OCBP explained that it had not undertaken this level of detailed work whilst uncertainty remained as to whether the sale would proceed.

The combined businesses

Rockwool's projections and the financial case for the acquisition

3.36. The Rockwool case for the acquisition of Queensferry rested to a considerable extent on the enhancement to the present value of the projected cash flows that the acquisition would bring and the internal rate of return (IRR) of the net incremental cash flows. The basis of the Rockwool evaluation was a comparison of the business plan without the acquisition (see paragraphs 3.18 to 3.20) with the projected position including the acquisition of Queensferry. As indicated in paragraph 3.20, there are capacity limitations at the Bridgend plant and to meet gradually rising demand Rockwool had considered both construction of a third production line at Bridgend and an increase in the volume of imports. The business plan for the acquisition envisages initial production and sales from Queensferry of 22,000 tonnes to add to the existing production at Bridgend of 81,000 tonnes. The Queensferry output would effectively go to existing customers of OCBP or be bought by OCBP under the Supply Agreement (see paragraph 3.5 and Appendix 3.1). Thereafter Rockwool, in addition to environmental improvements at the Queensferry plant, plans to expand output there by up to 15,000 tonnes by 2001; the extra output from Queensferry would then replace some of the higher imports for which provision had been made in the business plan without the acquisition.

3.37. After allowing for the proposed acquisition cost of £[] million (£[] million with allowance for purchase expenses) together with capital expenditure at Queensferry of £[] million in 1999 and 2000 and a total of £[] million by 2005, the expected effect of the acquisition is to increase the present value (using a discount rate of 10 per cent) of the future cash flows of Rockwool from £[] million to £[] million, an increase in present value terms of £[] million. The associated IRR on the acquisition is put by Rockwool at [] per cent, which compares with the hurdle rate for investment used in the Rockwool International group of 9 per cent. Details of the cash flows including the acquisition of Queensferry are given in Table 3.7. As indicated above, Rockwool calculated the present value of the total incremental cash flows (including periods after 2005 and an

outflow of £[] million in 1998, after allowing for a purchase price for Queensferry of £[] million) at £[] million, when discounted at 10 per cent.

TABLE 3.7 Rockwool: business plan with the acquisition of the Queensferry business

| | £ million | | | | | | |
|--|-----------|------|------|------|------|------|------|
| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Quantity sold ('000 tonnes) | | | | | | | |
| Invoiced sales | | | | | | | |
| Net sales ex works | | | | | | | |
| Contribution ratio (%) | | | | | | | |
| Profit before tax | | | | | | | |
| Profit after tax | | | | | | | |
| Cash flow from operations* | | | | | | | |
| Investment in fixed assets | | | | | | | |
| Cost savings and capacity increases | | | | | | | |
| Cash flow | | | | | | | |
| Cash flow without acquisition— Table 3.4 | | | | | | | |
| Incremental cash flow | | | | | | | |
| Present value of incremental cash flow after discounting @ 10% | | | | | | | |

Figures omitted. See note on page iv.

Source: Rockwool.

*Includes the effect of the acquisition of the initial 22,000 tonnes capacity at Queensferry, but not the effect of the expansion of capacity by up to a further 15,000 tonnes. The effect of efficiency savings from the acquisition and the substitution of projected imports by additional production from Queensferry is shown in the cost savings and capacity increases line.

3.38. An important input to the Rockwool post-acquisition business plan is the assumptions made on future prices. The original business plan assumed that prices would rise by 1 per cent each year, whereas in the acquisition business plan a further assumption was included that the average prices of all sales—Bridgend output, imports and Queensferry output—would rise by an additional 1 per cent in the three years 1999 to 2001. Although the higher increases would take place only in the three years, the assumption is made that the higher price level then attained would continue in future years. We have calculated that the effect of the further price increase accounts for some £14 million of the net present value of the projected incremental cash flow from Queensferry. In the absence of the further price increase the IRR on the acquisition would fall from [] to [] per cent.

3.39. Following the acquisition, the intention of Rockwool would be to price former OCBP products at Rockwool prices. Although the stone wool products offered by Rockwool and OCBP are similar, Rockwool is the acknowledged market leader and as a result its realized prices for equivalent products might be expected to be somewhat higher than those of OCBP. Both Rockwool and OCBP have confirmed to us the likelihood that this effect is present. Rockwool told us that it had no detailed knowledge of OCBP's prices but that the extent of the difference for certain equivalent products might lie within the 5 to 10 per cent range and that overall the price difference could be of the order of 1 or 2 per cent.

3.40. Rockwool has assumed for its business plan (using data received in the course of the due diligence process) that as a result of different sales mixes the average price per tonne of OCBP sales in 1998 was 10 per cent higher than that of Rockwool sales. The robustness of the Rockwool financial case for the acquisition is therefore dependent to some extent on the accuracy of the assessment of the difference in product mix and the ability of the company to maintain the price difference into the future.

3.41. A comparison of Table 3.7 with Table 3.4 shows a substantial increase in projected capital expenditure as a result of the Queensferry acquisition—£[30] million in 1999 and £[30] million in 2000; thereafter the increase as a result of ongoing replacement would be just over £[30] million a year, a figure consistent with the size of Queensferry relative to the existing Rockwool business. The investment in 1999 and 2000 includes, respectively, £4.6 million for environmental improvements and £[30] million for expansion of the Queensferry capacity by way of de-bottlenecking.

OCBP's plans in the absence of the merger

3.42. Owens Corning told us that if the transaction was not permitted to proceed it would have to review what steps it could take to improve the profitability of the Queensferry business. It said that because the group did not perform basic stone wool research and development and had no particular strengths in stone wool manufacturing, it would neither plan to expand future plant capacity at Queensferry nor make the commitment to expand its research and development to support stone wool manufacturing. The likelihood was that OCBP would embark on a restructuring programme at Queensferry to improve plant profitability, even if the Owens Corning group decided to sell the plant to another party. Owens Corning stressed that no definite or contingency plans had been made or approved. With the continuing focus on improving shareholder value the Owens Corning group, along with other manufacturers, had to strive to maintain a low-cost manufacturing operation. The group had in the past carried out similar restructuring reviews in respect of plants in Belgium and the USA. In 1998 at Visé in Belgium it had been decided to reduce the number of product lines and staff levels in an effort to reduce costs and focus on the most profitable lines. In view of the pending disposal of Rockwool no restructuring and rationalization had so far occurred at Queensferry. Towards the end of the inquiry Owens Corning told us that, as a result of uncertainty over the future of Queensferry, demand in the early months of 1999 had fallen. As a result OCBP was considering measures including a reduction in the number of shifts and elimination of loss-making product lines if the merger were not permitted to go ahead. Although Owens Corning would quickly look for another buyer for Queensferry, it doubted the feasibility of finding one (see paragraphs 6.116 to 6.120).