Part II

Background and evidence

3 The parties and the background to the merger

Contents

Page

Introduction

3.1. This chapter deals with the businesses of the parties. It provides information about the history and financial performance of each party and provides a summary of the transaction that created the joint venture consisting of Locker’s subsidiary, Pentre and Sylvan’s subsidiary, Askern. It concludes with details of the rationale provided by the parties for the merger.

3.2. As the merger involves both Pentre and Askern, consolidated results for each have been reported. However, as this reference concerns the supply of drums, including drum management, within the UK, the analysis has mainly focused on this specific part of Pentre’s and Askern’s respective operations.

Locker Group plc

History and operations

3.3. Locker was incorporated in 1947 under the name Thomas Locker and Company Limited. On 1 April 1960 the company was renamed Thomas Locker (Holdings) Limited and on 2 November 1981 it was reregistered as a public limited company. In 1998 the company was renamed Locker Group plc.

3.4. Prior to January 1996, Locker was a small quoted company engaged in a number of engineering activities, with a turnover of approximately £30 million a year. It was controlled by the Locker family. Locker advised us that by the mid-1990s there were management problems and a realization that the company needed to increase its critical mass. At about the same time, the management of Pentre, whose history is set out in paragraphs 3.9 to 3.15, came to the view that a listing of its shares would be desirable as a means of funding future acquisitions.

3.5. In January 1996 Locker and Pentre agreed to merge. Pentre's shareholders gained 47 per cent of the enlarged group and Pentre's chairman and chief executive became respectively executive chairman and chief executive of Locker (see paragraph 3.9). Since then, Locker's business has been consolidated through various acquisitions and rationalizations. Locker now carries on a number of general engineering businesses, including the manufacture of specialized mechanical handling equipment, filtration equipment, woven wire, perforated metal products, and drums for the cable and wire industry.

3.6. The corporate structure of Locker prior to the creation of the joint venture is set out in Appendix 3.1.

3.7. Pentre was responsible for all of Locker's drums business and it and its subsidiaries are the only companies within the Locker group included in the joint venture.

3.8. Table 3.1 shows the extent to which Pentre contributed to the turnover of Locker.

TABLE 3.1 **Pentre: contribution to the turnover of Locker**

£ million

	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
Locker—turnover	64.5	63.3	63.1	60.4
Pentre—turnover included in Locker	29.2	30.5	29.8	29.2
Pentre percentage of Locker	45.3	48.2	47.2	48.3

Source: Locker statutory accounts and Pentre consolidations (see paragraph 3.24).

History of Pentre

3.9. The Pentre division was created in 1988 by Michael Seymour and Philip Gartside who subsequently became the Chief Executive and Executive Chairman of Locker respectively (see paragraph 3.5). The Pentre division initially consisted of three small, former family-owned businesses, two of these manufacturing drums (Warrington Wheel Co Limited and Dean Brothers Limited) and the other focusing on wire and cable machinery (Larmuth Engineering Limited).

3.10. A year later, Pentre acquired Hearl Heaton & Sons Limited (HHS), a manufacturer of precision reels located in West Yorkshire with markets in virtually every developed country in the world.

3.11. In October 1992, Pentre acquired Sonoco Reels Limited, a supplier of plywood and cardboard drums mainly to UK cable companies, and located in Leigh, Lancashire.

3.12. In March 1993, ECI Ventures Nominees Limited invested £1 million in Pentre in return for a 33 per cent shareholding. Coincident with the ECI investment, Pentre acquired its Danish competitor Heas A/S, which manufactured process drums and exported to a large number of international markets.

3.13. Later that year, Pentre extended the product range of its UK packaging businesses by acquiring a softwood drum company located in Knowsley, Merseyside.

3.14. Over the next two years the group acquired:

(a) the assets of Meltech Engineering at Blackburn, a small company manufacturing for the wire and cable industry, which were combined with Larmuth;

(b) a softwood drum business in Finland, now renamed Pentre Finland, which also supplies plywood drums and plywood boxes to its local market;

(c) Industrial Reels Limited in Wigan, which added a range of fully moulded plastic drums to the Pentre product range as well as securing the supply line of large ABS plastic flanges to HHS; and

(d) a manufacturing unit at Chadderton near Oldham, to act as a service depot for the BICC Telecommunications Blackley plant, later bought by Belden.

3.15. In 1996 Pentre took over responsibility for the retrieval, repair and redelivery of BICC's timber drums (known as drum management services, which are described in paragraph 4.17). To facilitate this, a drum management database system was developed and a return and repair depot was established in Runcorn, Merseyside. Local assembly and drum management systems were subsequently introduced to Andrew in Scotland, Pirelli in Wales and NK Cables OY in Finland. As a consequence, Pentre established three further small satellite depots in 1997 and 1998.

3.16. The companies (some of which are dormant), businesses and assets described in paragraphs 3.9 to 3.15 are all owned by Pentre (Holdings) Limited either directly or via its wholly-owned subsidiary, Pentre Group Limited. Pentre (Holdings) Limited is purely an investment company and the principal activities of its subsidiaries are described in paragraphs 3.19 to 3.22.

3.17. The corporate structure of Pentre, prior to its merger with Askern, is set out in Appendix 3.2, and is briefly discussed in paragraphs 3.18 to 3.22.

Principal activities of Pentre

3.18. Pentre manufactures and supplies a range of timber, steel, plywood, cardboard and plastic drums, the purpose of which is to facilitate transportation of cable, wire, rope and other linear wound products from their point of manufacture to their point of end use. Pentre also produces process reels, which are highly engineered products, designed to run at high speeds and/or to critical tolerances for use in a variety of manufacturing situations. Pentre also supplies drum management services, plastic trade mouldings and plywood boxes.

3.19. The principal trading entities of Pentre Group Limited comprise the following divisions:

(a) UK Packaging Division;

(b) Process/Industrial Reels and Drums Division; and

(c) Finland.

3.20. The UK Packaging Division is conducted by Pentre Reels Limited which manufactures timber, plywood and cardboard drums. It also undertakes drum management services.

3.21. The products and services supplied by the Process/Industrial Reels and Drums Division, by company, are as follows:

(a) Pentre Engineering Limited, which manufactures steel drums (for both packaging and process reels), stands and drum handling equipment, turntables and coil makers;

(b) IR Holdings Limited, the intermediate holding company holding 100 per cent of the share capital of Industrial Reels Limited;

(c) Industrial Reels Limited, a manufacturer of a range of fully moulded plastic drums for the cable and wire industry, and other injection moulded products including ABS plastic flanges. It also carries on a trade moulding activity; and

(d) Pentre Group A/S, incorporated in Denmark, which manufactures precision steel reels and drums, and assembles timber drums for the local market.

3.22. The Finland operations are conducted by Pentre Finland OY which manufactures timber drums, carries out drum management activities, and manufactures a range of plywood boxes and other packagings.

3.23. Further details of the drums industry, and of Pentre's role within it, are given in Chapter 4.

Financial performance of Pentre

3.24. The financial information for Pentre included in this report has been provided by Pentre's management. It has not been audited. Pentre's accounts for the years 1996 to 1999 formed part of Locker's audited accounts and as such sub-consolidations were not normally undertaken and the information did not need to be audited. Financial information prior to 1997 has not been included as Pentre's financial year was changed from December to March following its acquisition by Locker in January 1996 (see paragraph 3.5). Pentre advised us that the information would be difficult to present and would be of limited value for comparative purposes as it would be for a 15-month period. Meltech-Larmuth Limited was previously part of Pentre but was not included in the joint venture as it is not involved in the drums business. It was sold to Locker on 7 March 2000. It has therefore been excluded from the financial information presented in this report.

3.25. The consolidated profit and loss accounts of Pentre are set out in Table 3.2. Unlike the results for 1997 to 1999, the results for 2000 do not include any group charges. Pentre advised that, given it was being sold to the joint venture, it was inappropriate for it to bear a share of Locker's central overheads.

TABLE 3.2 **Pentre: consolidated profit and loss accounts**

£ million

	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
Turnover	29.2	30.5	29.8	29.2
Cost of sales	(21.0)	(21.9)	(19.7)	(18.9)
	8.2	8.6	10.1	10.3
Net operating expenses	(6.5)	(7.6)	(8.0)	(7.3)
Operating profit/(loss)	1.7	1.0	2.1	3.0
Net interest payable and similar charges	(0.8)	(0.2)	(0.7)	(0.5)
Profit/(loss) on ordinary activities before taxation	0.9	0.8	1.4	2.5
Tax on profit/(loss) on ordinary activities	(0.2)	(0.2)	(0.1)	(0.7)
Profit/(loss) for the financial year and retained profit/(loss)	0.7	0.6	1.3	1.8

Source: See paragraph 3.24.

3.26. Table 3.3 shows the turnover by geographic market supplied. Approximately half of Pentre's operations over the past four years have supplied the UK market.

TABLE 3.3 **Pentre: turnover by geographical market supplied**

£ million

	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
UK	15.4	15.4	15.0	15.6
Rest of Europe	10.5	10.5	10.8	8.9
Rest of world	3.3	4.6	4.0	4.7
Total	29.2	30.5	29.8	29.2
UK percentage	52.7	50.5	50.3	53.4

Source: See paragraph 3.24.

3.27. The consolidated balance sheets for Pentre are set out in Appendix 3.3 and summarized in Table 3.4. Pentre pointed out that the net assets/shareholders' equity amounts are net of the inter-company indebtedness between Pentre and Locker which, it explained, should be considered part of Locker's investment in Pentre. Pentre told us that the net liability, included in arriving at net assets, in 2000 amounted to £8.8 million which would increase net assets/shareholders' equity from £4.5 million to £13.3 million.

TABLE 3.4 **Pentre: summarized consolidated balance sheets**

£ million

	As at 31 March			
	1997	*1998*	*1999*	*2000*
Fixed assets	12.2	11.4	11.4	10.9
Current assets	13.5	12.3	12.3	13.3
Total assets less current liabilities	8.9	8.7	10.0	5.9
Net assets/shareholders' equity	6.4	6.7	8.2	4.5

Source: See paragraph 3.24.

3.28. Turnover and operating profit for each of the principal trading entities is set out in Table 3.5.

TABLE 3.5 **Pentre: turnover and operating profit for each of the principal trading entities**

£ million

	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
Turnover				
UK Packaging Division	10.6	10.7	10.9	10.9
Process/Industrial Reels and Drums Division	14.7	15.7	14.6	13.6
Finland	3.9	4.1	4.3	4.7
	29.2	30.5	29.8	29.2
Operating profit/(loss)				
UK Packaging Division	0.4	0.1	0.6	1.1
Process/Industrial Reels and Drums Division	0.5	0.2	0.4	0.9
Finland	0.6	0.5	0.9	1.0
Dormant companies and central costs	0.2	0.2	0.2	-
	1.7	1.0	2.1	3.0

Source: See paragraph 3.24.

3.29. Table 3.6 shows Pentre's turnover and operating profit analysed by country of origin for its UK and overseas operations. Pentre's production in the UK amounted to approximately three-quarters of its total production over the past four years. With the exception of 1998, approximately 60 per cent of total operating profit came from UK production.

TABLE 3.6 **Pentre: turnover and operating profit by country of manufacture**

£ million

	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
Turnover				
UK operations	21.9	23.3	22.0	22.8
Overseas operations	7.3	7.2	7.8	6.4
	29.2	30.5	29.8	29.2
UK operations as a percentage of total operations	75.0	76.4	73.8	78.1
Operating profit/(loss)				
UK operations	1.1	0.4	1.2	1.9
Overseas operations	0.6	0.6	0.9	1.1
	1.7	1.0	2.1	3.0
UK operations as a percentage of total operations	64.7	40.0	57.1	63.3

Source: See paragraph 3.24.

Pentre's UK Packaging Division

3.30. The profit and loss accounts and balance sheets for Pentre's UK Packaging Division are set out in Appendices 3.4 and 3.5. Table 3.7 shows its profitability.

TABLE 3.7 **Pentre UK Packaging Division: profitability**

£ million

	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
Turnover	10.6	10.7	10.9	10.9
Operating profit/(loss)	0.4	0.1	0.6	1.1
Average net assets	1.3*	1.3	1.5	1.4
Key ratios				
Return on sales	3.8	0.9	5.5	10.1
Return on average net assets	30.8	7.7	40.0	78.6

Source: See paragraph 3.24/CC analysis.

*Closing net assets used (not average).

3.31. As can be seen from Table 3.7, there has been a slight increase in turnover from £10.6 million in 1997 to £10.9 million in 1999 and 2000. Operating profit, however, decreased from £0.4 million in 1997 to £0.1 million in 1998 before increasing to £0.6 million in 1999 and then £1.1 million in 2000. As indicated in paragraph 3.25, operating profit in 2000 is not comparable to the operating profits in 1997 to 1999 as there were no group charges applied in 2000. Group charges varying from £120,000 to £310,000 were applied in 1997 to 1999.

3.32. Return on sales and return on average net assets reflect the same pattern as operating profit, particularly in relation to the decline in 1998. Specifically, return on sales decreased from 3.8 per cent in 1997 to 0.9 per cent in 1998 before increasing to 5.5 per cent in 1999 and then to 10.1 per cent in 2000. Had operating profit in 2000 included group charges of a similar amount to that in 1999 (ie £150,000), this would have decreased operating profit to £0.9 million and return on sales for 2000 would have reduced from 10.1 per cent to 8.2 per cent.

3.33. Return on average net assets decreased from 30.8 per cent in 1997 to 7.7 per cent in 1998 before increasing to 40.0 per cent in 1999 and then to 78.6 per cent in 2000. In addition to the distortion in relation to operating profit, Pentre also pointed out (see paragraph 3.27), that the average net asset amounts are net of the inter-company indebtedness between Pentre and Locker which, if adjusted for these amounts, would increase the asset base and therefore reduce the return achieved.

3.34. Pentre told us that the results for 1997 suffered from the higher material costs for timber and plywood costs not being properly controlled. (Table 4.9 records a fall in raw material prices in 1997. However this table is calculated on a calendar year basis as distinct from a financial year basis to which this comment relates.) Plywood, cardboard and timber products were subsequently all brought together under a single management structure. 1997 saw the first income from Pentre's drum management services.

3.35. Pentre told us the significant decline in operating profit in 1998 was due to higher group charges. Sales of new timber drums declined as a result of a decline in demand from BICC. This was compensated by additional income from plywood drum exports and drum management revenues. Growth in plywood drum exports matched the decline in UK demand. Drum management income increased.

3.36. Pentre told us that 1999 saw an increase in overheads as a result of the establishment of satellite operations and a stronger accounting function. Further customers for timber drums were located to make up for erosions caused by improved drum management. Profit contribution from new timber drums was also increased as sales increased to £2.2 million from the low of £1.6 million in 1997.

3.37. Pentre told us that sales remained relatively stable during 2000 with declines in the sale of new timber drums due to the restructuring within BICC being offset by increased revenue from more profitable drum management contracts. Gross margins improved by 8 per cent despite price competition placing downward pressure on gross margins particularly in cardboard and plywood drums. The gross margin improvements were due to reductions in the price of key raw materials as well as reductions in labour costs.

Pentre's UK Process/Industrial Reels and Drums Division

3.38. As stated in paragraph 3.21, Pentre's Process/Industrial Reels and Drums Division consists of four companies: three operating in the UK and one in Denmark. The division essentially manufactures steel process reels, steel shipping drums and plastic drums. As the steel process reels and steel shipping drums are manufactured by the same corporate entity (Pentre Engineering Limited), Pentre was unable to produce separate accounts for these two products. Accordingly, the analysis which follows in paragraphs 3.39 to 3.46 represents the combined results for the three main product types. However, the results are for the UK operations only (ie they exclude the results of the Danish company, Pentre Group A/S).

3.39. The balance sheets for Pentre's UK Process/Industrial Reels and Drums operations are set out in Appendix 3.6. Pentre was unable to provide us with full profit and loss accounts for its UK Process/Industrial Reels and Drums operations. Instead it provided us with turnover and operating profit results. Table 3.8 shows its profitability.

TABLE 3.8 **Pentre UK Process/Industrial Reels and Drums operations: profitability**

				£ million
	Years ended 31 March			
	1997	*1998*	*1999*	*2000*
Turnover	12.8	14.0	13.0	12.2
Operating profit/(loss)	0.3	0.5	0.7	1.1
Average net assets	3.2*	3.3	3.5	2.9
Key ratios				
Return on sales	2.3	3.6	5.4	9.0
Return on average net assets	9.4	15.1	20.0	37.9

Source: See paragraph 3.24/CC analysis.

*Closing net assets used (not average).

3.40. As can be seen from Table 3.8, turnover increased from £12.8 million in 1997 to £14.0 million in 1998 before declining over the next two years to £12.2 million in 2000. Despite the decline in turnover, operating profit steadily increased over the four years from £0.3 million in 1997 to £1.1 million in 2000. As indicated in paragraph 3.25, operating profit in 2000 is not comparable to the operating profits in 1997 to 1999 as there were no group charges applied in 2000. Group charges varying from £656,000 to £885,000 were applied in 1997 to 1999.

3.41. Return on sales increased over the period from 2.3 per cent in 1997 to 9.0 per cent in 2000. Had operating profit in 2000 included group charges of a similar amount to that in 1999 (ie £656,000), this would have decreased operating profit to £0.5 million and return on sales for 2000 would have reduced from 9.0 to 4.1 per cent.

3.42. Return on average net assets increased from 9.4 per cent in 1997 to 37.9 per cent in 2000. In addition to the distortion in relation to operating profit, Pentre also pointed out (see paragraph 3.27) that the average net asset amounts are net of the inter-company indebtedness between Pentre and Locker, which, if adjusted for these amounts, would increase the asset base and therefore reduce the return achieved.

3.43. Pentre told us that sales and profits from its plastic drums remained strong during 1997, contributing £400,000 towards profit. Sales of steel shipping drums to UK customers accounted for £1.9 million of turnover.

3.44. Pentre told us that the 1998 results showed a better performance on steel process reels as the US market started to take off. The price of plastic fell leading to higher margins on ABS plastic drums. Moulded products saw sales and profits fall, the latter by over £200,000 as management and control issues surfaced as well as stronger UK competition from drum imports. Sales of steel shipping drums to UK customers again accounted for around £1.9 million of turnover.

3.45. Pentre told us that the results for 1999 remained largely unchanged from the previous year despite the strengthening of the pound and a major reduction in demand from Asia. Strong demand from the USA meant that process reels staged a recovery and balanced lower profits elsewhere particularly for fully moulded plastic drums where quality problems were a major factor. A decision was taken to reduce activity levels at the Wigan trade moulding operation.

3.46. Pentre told us that the reduction in turnover for 2000 was due to a number of factors including: increased pressure on margins from competitors; the continued strength of the pound which affected export sales; rationalization within the cable and wire industry both within the UK and Mainland Europe; a general downturn in the UK wire industry; overcapacity within the cable industry; a lack of substantial orders from the offshore oil industry; and increases in the price of steel and plastic. A decision was made to discontinue the supply of certain trade moulding customers where margins were particularly low. This reduced the number of employees at the Wigan injection moulding unit from 79 to 42. There was also a greater reliance on low-margin skeletal steel drum work at the expense of timber drums.

Sylvan International Limited

History and operations

3.47. Sylvan is owned as to 76.9 per cent by Alchemy Partners Nominees Limited on behalf of Alchemy (Guernsey) Limited, the plan manager of the Alchemy Investment Plan. The remaining 23.1 per cent of the shares are held by the management. The Alchemy Investment Plan comprises a number of limited partnerships, each representing one investor. Investors in the Alchemy Investment Plan include major banking institutions, pension funds and a number of individuals.

3.48. Sylvan was formed on 10 March 1998, and was originally known as Deltamove Limited. It was established specifically for the purpose of acquiring MLM which specializes in the importation, manufacture, and distribution of timber and panel products. Sylvan acquired Askern in July 1998. It subsequently acquired:

(a) WTR Limited (WTR), a manufacturer and distributor of cardboard drums (subsequently a subsidiary of Askern);

(b) Edens Trading Group, a panel products distributor, in July 1999; and

(c) Profile Timber Limited, which specializes in the importation, manufacture and distribution of timber products, in February 2000.

3.49. Sylvan owns and operates a number of businesses in the timber products sector. The acquisitions which it has made over the last two years reflect its strategy of creating a diverse timber products group. Askern was responsible for all of Sylvan's drum business and it and its subsidiaries are the only companies within the Sylvan group that were included in the joint venture.

3.50. The corporate structure of Sylvan prior to the creation of the joint venture is set out in Appendix 3.7.

3.51. Table 3.9 shows the extent to which Askern contributed to the turnover of Sylvan.

TABLE 3.9 **Askern: contribution to the turnover of Sylvan**

£ million

	Years ended 31 March	
	1999	*2000*
Sylvan—turnover	160.5	196.0
Askern—turnover included in Sylvan	21.8*	31.2
Askern percentage of Sylvan	13.6*	15.9

Source: Sylvan statutory accounts and Askern accounts (see paragraph 3.64).

*As Sylvan acquired Askern only on 28 July 1998, the results cover only the eight months from August 1998.

History of Askern

3.52. Askern commenced trading in 1948. Initially a family business, it comprised a saw mill operating in Askern, near Doncaster, and later went on to manufacture timber drums for the cable industry. A number of acquisitions of UK based drum businesses followed, some formerly owned by cable manufacturing companies. This led Askern to expand its product range from timber drums to plywood, steel and cardboard drums.

3.53. In 1993, Askern was listed on the London Stock Exchange to facilitate further growth. It subsequently acquired softwood drum businesses in France, Finland and Ireland. In 1996, Askern acquired the assets of a UK cardboard drum manufacturer, Curran Packaging Company Limited, further broadening the group's product range. A rights issue followed in 1997 to facilitate the acquisition of the SOTAC Group based in France and Belgium, which is engaged in the manufacture and repair of timber drums.

3.54. During 1998, Askern's share price was at a low level. This, combined with other factors, led to the purchase of Askern by Sylvan in July 1998. A newly incorporated wholly-owned subsidiary of Sylvan, Island Gogh Limited (IGL), was established specifically for the purpose of acquiring Askern.

3.55. Askern was delisted from the London Stock Exchange on 23 September 1998 and reregistered as AG Holdings Limited. It changed its name to Askern Group Limited on 18 August 1999.

3.56. In 1999, Sylvan acquired WTR, a manufacturer and distributor of cardboard drums, which was subsequently transferred to Askern (see paragraph 3.48).

Principal activities of Askern

3.57. Like Pentre, Askern manufactures and supplies a range of timber, steel, plywood and cardboard drums for the packaging and distribution of energy and communications cable, wire and wire rope (see paragraph 3.18). Askern also offers drum management services. However, unlike Pentre, Askern does not manufacture plastic drums, process reels, plastic trade mouldings or plywood boxes.

3.58. The corporate structure of Askern, prior to its merger with Pentre, is set out in Appendix 3.8 and is briefly discussed in paragraphs 3.59 to 3.62.

3.59. The products and services supplied by the principal UK operating companies are as follows:

(a) Askern UK Limited, which at various sites in the UK (principally Doncaster and Birtley) manufactures timber, cardboard and plywood drums, and also provides drum management services;

(b) Askern Steel Reels Limited (ASR), which manufactures steel shipping drums at its site in Dinnington;

(c) WTR Limited, which manufactures cardboard drums at its Workington plant; and

(d) Askern Scotland Ltd, which assembles timber and plywood drums, and which is based in Glenrothes.

3.60. Other UK companies include Askern Properties Limited, which owns one of the freehold properties occupied by Askern UK Limited, and RNH Wood Products (UK) Limited (now Askern Saw Mills Limited) which undertook drum management services but ceased operation in March 1999 (see paragraph 3.75).

3.61. In addition, RTL, owned as to 50 per cent by Askern, was a timber sourcing business. Approximately one-third of its sales went to Askern. Following the acquisition of Askern by Sylvan in July 1998, all timber and plywood was purchased through MLM, another subsidiary of Sylvan (see Appendix 3.7) rather than RTL (see paragraph 3.89). Accordingly, RTL ceased operation in January 1999.

3.62. The principal overseas operating companies, and the products and services they supply, are as follows:

(a) Emballage Manutention Stockage SA (France), which manufactures timber drums and assembles plastic drums;

(b) Mouret Bobines et Tourets Bois SA (France), which produces timber drums;

(c) SOTAC (France), which manufactures plywood and timber drums;

(d) Services-Productions SARL (France) and Services-Productions SA (Belgium) which provide drum management and repair services;

(e) AG (Overseas) Limited which is the intermediate holding company of RNH Wood Products Limited (Ireland), which manufactures timber, plywood and cardboard drums; and

(f) AG-Kaapelikelat Oy (Finland), which manufactures timber drums.

3.63. Further details of the drum industry, and of Askern's role within it, are given in Chapter 4.

Financial performance of Askern

3.64. The consolidated results of Askern have been extracted from Askern's audited accounts for the years ending 31 July 1996 to 1998 and the year ending 31 March 1999. The auditors reported without qualification. Askern's management provided draft accounts for the year ending 31 March 2000. Askern's management also separately provided the financial information relating to Askern's UK drums operations. The results for the period ended 31 March 1999 are for eight months, due to the change of year end following the acquisition of Askern by Sylvan in July 1998 (see paragraph 3.54).

3.65. The consolidated profit and loss accounts for Askern are set out in Table 3.10.

TABLE 3.10 **Askern: consolidated profit and loss accounts**

£ million

	Years ended				
	31 July			*31 March*	
	1996	*1997*	*1998*	*1999**	*2000*
Turnover	29.3	35.0	36.5	22.4	31.2
Cost of sales	(20.3)	(25.7)	(26.7)	(16.6)	(23.0)
	9.0	9.3	9.8	5.8	8.2
Net operating expenses	(5.2)	(6.0)	(6.5)	(4.3)	(6.3)
Operating profit/(loss) before exceptional items	3.8	3.3	3.3	1.5	1.9
Exceptional items†	-	(0.4)	(0.9)	(3.2)	(0.5)
Operating profit/(loss) after exceptional items	3.8	2.9	2.4	(1.7)	1.4
Net interest payable and similar charges	(0.4)	(0.4)	(0.4)	(0.2)	(0.3)
Profit/(loss) on ordinary activities before taxation	3.4	2.5	2.0	(1.9)	1.1
Tax on profit/(loss) on ordinary activities	(1.1)	(0.9)	(0.6)	0.3	(0.1)
Profit/(loss) on ordinary activities after taxation	2.3	1.6	1.4	(1.6)	1.0
Minority interests	(0.1)	(0.1)	-	0.1	-
Profit/(loss) for the financial year	2.2	1.5	1.4	(1.5)	1.0
Dividends	(1.1)	(1.3)	(0.5)	-	-
Retained profit/(loss) for the year	1.1	0.2	0.9	(1.5)	1.0

Source: See paragraph 3.64.

*Results are for eight months only as the year end changed from July in 1998 to March in 1999.

†Exceptional items relate principally to rationalization and acquisition costs in each year. However, in 1999, it also included the cost of a fair value adjustment of £2.1 million to assets.

3.66. Table 3.11 shows the turnover by geographic market supplied. In 1996, over 70 per cent of Askern's sales were for the UK market. This has gradually declined over the past five years so that in 2000, just over half of Askern's sales supplied the UK market.

TABLE 3.11 **Askern: turnover by geographical market supplied**

£ million

	Years ended				
	31 July			*31 March*	
	1996	*1997*	*1998*	*1999**	*2000*
UK	20.6	24.3	23.2	13.1	16.5
Rest of Europe	8.3	10.1	13.1	9.2	14.5
Rest of world	0.4	0.6	0.2	0.1	0.2
Total	29.3	35.0	36.5	22.4	31.2
UK percentage	70.3	69.4	63.6	58.5	52.9

Source: See paragraph 3.64.

*Results are for eight months only as the year end changed from July in 1998 to March in 1999.

3.67. The consolidated balance sheets for Askern are set out in Appendix 3.9 and summarized in Table 3.12.

TABLE 3.12 **Askern: summarized consolidated balance sheets**

£ million

	As at				
	31 July			*31 March*	
	1996	*1997*	*1998*	*1999*	*2000*
Fixed assets	8.1	10.2	11.1	11.3	11.2
Current assets	14.8	20.0	16.5	13.1	13.3
Total assets less current liabilities	13.4	16.7	16.3	14.0	14.8
Net assets/total capital employed	10.6	14.4	15.1	13.7	14.1

Source: See paragraph 3.64.

3.68. Table 3.13 shows Askern's turnover and operating profit analysed by country of origin for its UK and overseas operations. Askern's production in the UK amounted to over 80 per cent of its total production in 1996. This has steadily declined over the past five years, amounting to approximately 60 per cent in 2000.

TABLE 3.13 **Askern: turnover and operating profit by country of manufacture**

£ million

	Years ended				
	31 July			*31 March*	
	1996	*1997*	*1998*	*1999**	*2000*
Turnover					
UK operations	23.6	27.4	27.1	16.9	19.6
Overseas operations less consolidation entries	5.7	7.6	9.4	5.5	11.6
	29.3	35.0	36.5	22.4	31.2
UK operations as a percentage of total operations	80.5	78.3	74.2	75.4	62.8
Operating profit/(loss) before exceptional items					
UK operations	3.3	2.6	2.3	1.1	1.1
Overseas operations	0.5	0.7	0.9	0.4	0.8
	3.8	3.3	3.3	1.5	1.9
UK operations as a percentage of total operations	86.8	78.8	69.7	73.3	57.9

Source: See paragraph 3.64.

*Results are for eight months only as the year end changed from July in 1998 to March in 1999.

Askern's UK drum operations

3.69. The results for the UK operations noted in Table 3.13 include the results of RTL. As stated in paragraph 3.61, RTL was a timber sourcing company which ceased operation in January 1999. Accordingly, the results of RTL have been excluded from the analysis in paragraphs 3.70 to 3.78 in order to show the results for Askern's UK drum operations.

3.70. The profit and loss accounts and the balance sheets for Askern's UK drum operations are set out in Appendices 3.10 and 3.11. Table 3.14 shows its profitability.

TABLE 3.14 **Askern UK drum operations: profitability**

£ million

	Years ended				
	31 July			*31 March*	
	1996	*1997*	*1998*	*1999**	*2000*
Turnover	20.2	22.5	23.2	14.2	19.6
Operating profit/(loss) before exceptional items	3.1	2.2	2.2	1.2	1.0
Average net assets	8.5†	9.7	11.6	11.0	10.8
Key ratios					
Return on sales (before exceptional items)	15.3	9.8	9.5	8.5	5.1
Return on average net assets	36.5	22.7	19.0	10.9	9.2

Source: See paragraph 3.64/CC analysis.

*Results are for eight months only as the year end changed from July in 1998 to March in 1999.
†Closing net assets used (not average).

3.71. As can be seen from Table 3.14, Askern's UK drum operations have seen a steady decline in profitability. Operating profit before exceptional items has steadily declined from £3.1 million in 1996 to £1 million in 2000. Return on sales has reduced from 15.3 per cent in 1996 to 5.1 per cent in 2000. Similarly, the return on average net assets has reduced from 36.5 per cent in 1996 to 9.2 per cent in 2000.

3.72. Askern told us that the main adverse impact on profitability in 1997 was the strengthening of the pound which, at the beginning of the year, was 2.30 to the Deutschmark (DM), and at the end of the year was 3.01 to the DM. This reduced profits on exports dramatically. It also reduced the export business of Askern's customers which resulted in a reduction in the customers' demands for drums. Askern advised there was no offsetting effect from the strength of the pound in terms of lower timber import costs due to timber being a widely-traded commodity with prices generally being fixed in dollars. Askern said that the reduction in customers' exports has a disproportionate effect on their demand for drums as those used for exports of cable are used only once in the UK, and thus these customers sourced new drums rather than reused drums. The increase in imports of cable generally as a result of the strengthening of the pound affected cable wire production in the UK, and contributed to the reduction in the demand for drums whilst increasing the number of foreign drums finding their way on to the recycling market in the UK.

3.73. Offsetting the effects of the strengthening of the pound was an improvement in the performance by ASR (see paragraph 3.59) where operating profits improved by £150,000. In April 1996, the Curran cardboard drum business had been acquired (see paragraph 3.53) and its results were consolidated into those of Askern for the first time.

3.74. Askern told us that its UK operations continued to be adversely affected by the strong pound during 1998. Although the year-end rate was 2.91 to the DM, the average for the year was 2.96 as against 2.66 for the previous year. In September 1997, the plywood drum business of Williamsons was acquired. The Askern depot was closed, and thereafter the combined business operated from the Williamson site. This acquisition contributed approximately £750,000 to turnover. However, exceptional costs of £122,000 were incurred in the reorganization. ASR also suffered from reduced margins and its profits dropped by £60,000. The acquisition of Askern by Sylvan in July 1998 resulted in exceptional items of £722,000. These related to legal and professional fees and severance payments to the directors who left the business.

3.75. Askern told us that the 1999 results continued to be adversely affected by the strong pound, which traded at rates similar to those in 1998. 1999 was also the first period to be adversely affected by a new entrant to the timber drum market, YCD. Askern told us that YCD entered the market at prices substantially below the market price and thereby not only took market share from Askern but also caused margins to be reduced across the majority of the Askern customer base. RNH Wood Products (UK) Limited (see paragraph 3.60) was closed during the year due to its losing its only customer when its factory was closed. ASR had a particularly disappointing year with turnover substantially down due to the absence of any orders for large steel drums from the offshore oil and gas industry. Margins also continued to be affected by reduced prices at [*Details omitted. See note on page iv.*] parent company had instructed it to buy drums from a fellow subsidiary, a mining engineering business that had not previously produced drums. This not only reduced ASR's sales to [$] but also caused price decreases across the product range. ASR moved from a profit of £100,000 to a loss of £150,000 before exceptional items.

3.76. Askern told us the 1999 year benefited in comparison to the previous year from a substantial saving in group administration costs following the resignation, on the acquisition by Sylvan, of the chief executive, and the savings arising from the company no longer being quoted on the London Stock Exchange.

3.77. Askern told us that the timber drum business continued to be adversely affected during 2000 as a result of the entry of YCD. Additionally, the timber drum business was experiencing reduced demand arising from its customers rationalizing and looking to reduce costs by making more efficient use of their drum pools by improved drum management. In September 1999, a very large order was accepted from a German customer due to demand from the traditional customers being relatively low at that time. This was a particularly difficult order to produce and, because demand recovered in the UK, severe overrun in costs was incurred to produce this order. This resulted in a gross loss being incurred on this order of £[$].

3.78. ASR reduced its loss by approximately £130,000 during the year by better management. At the end of the previous year, Askern had purchased WTR (see paragraph 3.48) and in its first year WTR contributed £230,000 to operating profits.

3.79. In March 2000, Solomon Hare (SH) issued a due diligence report on Askern which was undertaken for Locker as part of the merger process. SH noted that the events of the past few months, with significant falls in gross profit, made the future more difficult to forecast. SH reported that, with price increases in line with a projected inflationary growth of 2.5 per cent, sustained cardboard turnover and further savings through planned rationalizations, Askern's UK operations should generate operating profits before exceptional items of £[$] million and £[$] million for the years ending 2001 and 2002 respectively. This was subject to a fundamental assumption that there was no further material loss of margin. Forecast operating profit for the year ending 2000 was estimated at £[$] million. Actual operating profit for 2000 was £1.4 million. Askern told us that for the month of April 2000, it made an operating loss of £24,000 and that the four-month forecast was expected to be below budget.

The merger

Events surrounding the merger

3.80. The developments in the market place discussed in paragraphs 3.92 to 3.97 prompted Locker and Sylvan, around late 1998, to discuss a merger of their respective drum businesses.

3.81. On 14 March 2000, Locker and Sylvan announced that they had agreed to transfer their respective drum businesses to a joint venture company to be owned as to 51 per cent by a subsidiary of Locker and 49 per cent by a subsidiary of Sylvan. The transaction was completed on 3 April 2000. It then became unconditional on 4 April 2000 after satisfaction of conditions precedent contained in a Credit Agreement and an Invoice Discounting Agreement. These documents cover the provision by Lombard NatWest Bank Ltd of a loan facility of £14.5 million and a committed invoice discounting facility of up to £7.5 million to enable the parties to fund the acquisition. The net assets and turnover of both Askern and Pentre were broadly the same; however, the stronger results of Pentre were the basis for the percentage shareholdings and for management control passing to Locker (see paragraph 3.87).

3.82. The Secretary of State referred the merger to the CC on 1 June 2000.

3.83. On 15 June 2000, Locker and Sylvan gave undertakings to the Secretary of State that they would maintain Pentre and Askern as separate operating units pending the outcome of this inquiry.

Details of the merger

3.84. The mechanics of the establishment of the joint venture are briefly as follows. IGL, a wholly-owned subsidiary of Sylvan (see paragraph 3.54 and Appendix 3.7), established a new company, Askern Holdings Limited (AHL), to act as the joint venture vehicle. On 7 March 2000, IGL sold the entire issued share capital of Askern to AHL for a sum of £13.3 million, of which £4 million was used to repay the inter-company loan created by IGL's subscription for shares in the capital of AHL, and the balance of £9.3 million was left owing to IGL on inter-company account. Of this £9.3 million, £9 million will be repaid out of the proceeds of new external debt finance raised by AHL.

3.85. Under the terms of the Pentre Acquisition Agreement, Locker Investments Limited (LIL), a wholly-owned subsidiary of Locker (see Appendix 3.1), disposed of its interest in Pentre to AHL at a price equivalent to the net asset value of Pentre at completion, estimated to be £4.665 million. Of this total consideration, £4 million took the form of an issue of new shares to LIL comprising 51 per cent of the issued shares in AHL, with £665,000 left outstanding on inter-company account. Final consideration is subject to adjustment based on the completed accounts. On completion, intra-group liabilities estimated at £9 million due to Locker from Pentre will be repaid out of the proceeds of new external debt finance raised by AHL. Completion of the Pentre Acquisition Agreement was conditional on shareholder approval at an EGM, which was obtained on 31 March 2000. AHL subsequently changed its name to Pentre Askern Group Limited (Pentre Askern).

3.86. Pentre Askern is a subsidiary of Locker and as such will be consolidated in the financial results of Locker.

3.87. Under the terms of the Shareholders' Agreement in respect of the joint venture, LIL is entitled to appoint up to four directors of the board of Pentre Askern, including the Chairman, Managing Director and Finance Director. IGL may appoint up to two directors. While most matters concerning Pentre Askern are to be decided by majority decision of the board, there are a large number of reserve matters which require the consent of both IGL and LIL. If the parties cannot agree on these matters, either party may refer the dispute to arbitration.

3.88. Under the Shareholders' Agreement, the parties have entered into certain restrictive covenants not to compete with the joint venture company in relation to the production and sale of drums for the packaging or dispatch of cable and wire in the UK. This restrictive covenant lasts for the duration of the joint venture and for a period of two years after either party withdraws from the joint venture.

3.89. Pentre Askern has entered into a Supply Agreement dated 3 April 2000 with MLM (see paragraph 3.61), pursuant to which MLM is the exclusive supplier of timber and timber products (including plywood and chipboard) to the joint venture business (except where lower prices are available elsewhere). This agreement is for a period of three years, following which it is terminable on three months' notice.

3.90. The establishment of the joint venture is being financed by the provision of £22 million of new syndicated debt facilities, led by National Westminster Bank plc. These new facilities will be secured on the assets of Pentre Askern and its subsidiaries. An estimated £18 million of this funding is being used to repay in equal amounts the indebtedness due to Locker from Pentre and due to Sylvan from Pentre Askern, as noted in paragraphs 3.84 and 3.85. However, these funds will remain in separate blocked accounts within each company, pending clearance of the merger by the Secretary of State for Trade and Industry.

3.91. In the event that the merger is not cleared following our inquiry, each party will repay to the bankers of Pentre Askern these sums of £9 million, and will in turn have the right to demand repayment of such amounts from Pentre Askern. If this happens, Locker will have the right to enforce security over the shares of the Pentre group of companies.

Reasons for the merger

3.92. Pentre Askern argued that the creation of the joint venture should be seen in the context of both the long-term trends within the cable and wire industry which impact upon the demand for and provision of drums, as well as a number of developments in the drum industry.

3.93. The long-term trends within the cable and wire industry were described as follows:

(a) significant overcapacity in the European cable industry with the result that:

(i) prices for certain cabling have been falling, leading to demands by manufacturers for reduced packaging costs; and

(ii) the last one to two years have witnessed a series of closures, rationalizations and acquisitions within the cable industry, with the result that UK production of cable is now predominantly controlled by a small number of major international groups and significant volumes of production have been moved overseas;

(b) many of the major purchasers of cable and wire in the UK are increasingly looking to source cable on as competitive a basis as possible, including importation from overseas sources; and

(c) the growth in cable imports has led to more overseas drums entering the UK market and being reused within the UK supply chain.

3.94. As a result of these trends Pentre Askern saw the implications for drum manufacturers in the UK to have been:

(a) loss of business in consequence of overseas sourcing of cable and wire;

(b) pressure from customers to achieve price reductions; and

(c) increasing competition.

3.95. The developments in the drum industry were described as follows:

(a) an increasing interest from overseas drum manufacturers to secure orders in the UK market;

(b) no significant barriers to entry in the manufacture and supply of drums resulting in new suppliers having considerable ease of entry;

(c) the potential for cable manufacturers to establish, or re-establish, in-house drum production operations in the UK as an alternative to outsourcing;

(d) the significant growth in the reuse of timber drums as an alternative to the purchasing of new drums; and

(e) the growing number of alternative methods of packaging cable and wire which compete with drums.

3.96. Pentre Askern advised that in view of these pressures, there has been a substantial decline in drum prices in recent years. Further, the decline in demand for drums has led to significant overcapacity, particularly in the supply of timber drums.

3.97. The issues in paragraphs 3.92 to 3.96 are discussed in more detail in Chapter 4.

Parties' expectation of the benefits of the merger

3.98. Pentre Askern expect that a number of synergies will be derived. There will be some re-organization and rationalization of manufacturing activities to eliminate duplicated resources and reduce overcapacity.

3.99. [*Details omitted. See note on page iv.*]

[

Details omitted. See note on page iv.

]

3.100. [

Details omitted. See note on page iv.

]

3.101. Pentre Askern consider that the joint venture will be able to achieve some cost reductions by purchasing raw materials (ie steel, timber and plywood) on a larger scale. These materials represent approximately half the total cost of the drum.

3.102. Pentre Askern expect the net economies, some of which arise in its overseas operations, to total £[$] million in the year ending 31 March 2002 with annual cost savings thereafter of £[$] million. A summary of the economies and costs are set out in Appendix 3.12. The anticipated purchase cost savings (see paragraph 3.101) and management initiative benefits (see paragraph 3.99) have not been quantified.

3.103. Forecast profit and loss accounts and balance sheets for the next five years (including the opening balance sheet) for Pentre Askern are set out in Appendices 3.13 and 3.14. A summary of the forecast results is set out in Table 3.15.

TABLE 3.15 **Pentre Askern: summary of forecast results**

£ million

	Years ended 31 March						
	2000†	*2000**	*2001*	*2002*	*2003*	*2004*	*2005*
Turnover							
Operating profit/(loss)							
Exceptional items							
Net interest and similar charges				*Figures omitted. See note on page iv.*			
Profit/(loss) before taxation							
Shareholders' equity							
Total debt							

Source: Pentre Askern business plan/CC analysis.

*For the year ended 31 March 2000, the profit and loss account was an aggregation, at the time the business plan was prepared (10 April 2000), of the estimated results of Pentre and Askern, and the closing balance sheet at 31 March 2000 was an estimate, at the time, of the opening position for the joint venture.

†An aggregation of the actual results for the year ended 31 March 2000 is given for comparative purposes.

3.104. The benefits arising from the proposed rationalizations are planned to commence with effect from 1 April 2001. This was to allow for the 'limbo' period imposed by the then anticipated reference of the merger to the CC during which time Pentre and Askern must be operated independently. The plan assumes that [

Details omitted. See note on page iv.

].

3.105. [

Details omitted. See note on page iv.

]

3.106. Pentre Askern expects that the savings from rationalization and purchase costs will enable the joint venture to increase investment in product development and innovation.

3.107. Pentre Askern expects that the joint venture will enable them to focus resources in developing further value added service initiatives for their customers, for example by developing more sophisticated drum management, repair and recycling operations, for which there is increasing demand from the cable producers.

3.108. However, the joint venture's cash flow will largely be required to repay debt, which is forecast to fall from £[$] in 2000 to [$] in 2004/05. The debt repayment programme is structured in accordance with the terms agreed with the financiers.

3.109. In relation to overseas development, Pentre Askern told us that, following the consolidation which is occurring in the cable industry, the UK production of cable is now predominantly in the hands of a small number of major cable groups with international operations. They are increasingly looking to their suppliers to provide an international capability, at least within European markets. [

Details omitted. See note on page iv.

]

3.110. Pentre Askern advised us that the ability to offer an international supply service in mainland Europe is becoming increasingly important, since it enables the cable producers to purchase raw materials, including packaging, to a consistent quality and standard for all their plants. Pirelli told us that they are increasingly trying to source packaging on an international basis.

3.111. [

Details omitted. See note on page iv.

]

3.112. Pentre Askern expects that its combined presence in overseas markets, including local manufacturing operations in France, Finland and Ireland, will enable the joint venture to begin to offer a more integrated sales and support network to the multinational cable producers in mainland Europe. Pentre Askern intends to grow its overseas operations through strategically placed investments in mainland Europe.

3.113. Pentre and Askern advised that, prior to the joint venture, they both exported a significant proportion of drums from their UK production facilities to overseas markets. Pentre exported 26 per cent (approximately £4 million) and Askern exported 18 per cent (approximately £3.5 million) in 1999. The parties advised that their principal export markets from the UK include Germany, France, Spain, the Netherlands and Belgium. There are also exports to markets outside Europe, including the Middle East. Pentre and Askern expect that by combining their operations they will have a larger and stronger platform from which to expand their activities in overseas markets.