Asia-Pacific
Economic Cooperation

2019/SOM1/CPLG/SEM/008

Merger Between Rea Magnet Wire Company and Xignux

Submitted by: Mexico

APEC
CHILE 2019

Seminar on Economic Analysis in Horizontal and Non-Horizontal Mergers
Santiago, Chile
28 February – 1 March 2019

Economic analysis in Horizontal and Non-Horizontal Mergers Workshop

Santiago, Chile

APEC 2019

cofece

Comisión Federal de Competencia Económica

Rea Magnet Wire Company & Xignux

Lizeth Martínez Nagore

February 2019

cofece

Comisión Federal de Competencia Económica

Merger between Rea Magnet Wire Company and Xignux

Index

- *Transaction.*
- *Merging parties activities.*
- *Magnet wire and its applications.*
- *Definition of the Relevant Market.*
- *Overlaps and Market Shares.*
- *Barriers to entry.*
- *Efficiency gains defence.*
- *COFECE's ruling.*

Merger between Rea Magnet Wire Company and Xignux

cofece

Transaction

In June, 2017 Rea Magnet Wire Company (Rea Magnet) and Xignux notified a merger before COFECE, since the transaction met the statutory thresholds.

The transaction implied the creation of a joint venture between Rea Magnet and Xignux's businesses dedicated to the manufacture and distribution of magnet wire in the United States and Mexico.

The JV would combine the NAFTA assets of both companies, as well as leverage operational and supply chain synergies, including an enamel manufacturing plant.

About Rea Magnet Wire Company

cofece

Rea Magnet Wire Company

Rea

Rea is a global wire manufacturer of magnet and non-ferrous wire products.

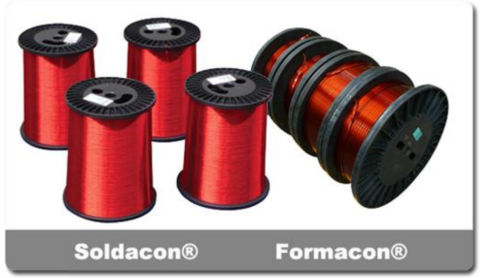
Rea is a US company with two subsidiaries in Mexico dedicated to the production of magnet and non-ferrous wire. Some of this products are copper and aluminium wires both bare and isolated, as well as electromagnetic wires.

Rea has six facilities, five located in the United States and one in Mexico.

About Xignux

Xignux

magnekon
Una marca Viakable



Xignux is a Mexican company with four business divisions: i) cables and electrical conductors, ii) transformers; iii) infrastructure and iv) food.

Viakable through Magnekom (subsidiaries of Xignux) produces and distributes the magnet wire. Magnekom has 4 facilities located in Mexico dedicated to the manufacture of cooper and aluminium cable for electric power transmission and distribution.

The company produces a broad variety of products with aluminium and copper conductors, including rectangular and square wire-bare, paper wrapped and coated.

What is a magnet wire and what is it used for?

Magnet wire and its applications

cofece

MAGNET WIRE

- *The magnet wire is manufactured using a bare wire, made of an electrical conductor, which is covered with an insulating material.*
- *The most common electrical conductors are copper and aluminium wire.*
- *The magnet wire is produced in different sizes and it could be done in different shapes, according to its industrial use.*

MAGNET WIRE APPLICATIONS

- *Magnet wire is used as input for a wide variety of products such as:*
  - *Motors for heating and air conditioning units,*
  - *Electrical appliances,*
  - *Electronics, telecommunications, electromechanical and automotive industries, among others.*

Definition of the Relevant Market

1. Substitution Analysis: product dimension

Merging Parties Arguments

- *The merging parties do not differentiate the magnet wire based on any of its physical characteristics. In that sense, they consider magnet wire as a generic category.*

- *The parties claimed that magnet wire is a commodity, due to its production relies on international standards established by independent specialized agencies. Therefore, the magnet wire is an homogenous and standardized product.*

COFECE's arguments

- *COFECE made a substitution analysis of the wire magnet based on its four physical dimensions, which are: i) the conductive material; ii) the shape required; iii) its thickness; and iv) the different types of insulating coating.*

- *COFECE found that the application manufacturers are the ones who determine and decide the conductive material, the required shape, its thickness and the type of insulating coating, depending on the industrial use of the wire. Therefore, is not a decision from the magnet wire manufacturers.*

- *In conclusion, COFECE determined that all types of magnet wires regardless its material, shape, caliber and coating must be considered into the same relevant market.*

Definition of the Relevant Market

cofece

1. Substitution Analysis: product dimension

Merging Parties Arguments

- *Magnet wire is a commodity.*
- *Its production is based on international standards established by specialized agencies around the world.*
- *There is no intellectual property that restricts its production in terms of processes or materials used in its production.*
- *The homogeneity and standardization of the magnet wire corroborates the conclusion that substitution exists on the supply side and that competitors have the ability to respond to new needs.*

COFECE's arguments

✓ *The machinery that makes the rectangular magnet wire can also make the round wire, but the other way around is not possible. Thus it is considered that on the supply side there is asymmetric substitution between both forms of magnet wire.*

✓ *However, the decision regarding the use of a particular form of magnet wire completely depends on the application manufacturers.*

✓ *On the basis of the above, it is therefore concluded that <u>from the demand side there is not substitution</u> of the magnet wire, but <u>from the supply side there is asymmetric substitution</u>.*

2. Substitution analysis: geographic dimension

Merging Parties Arguments

- *The merging parties considered a global geographic dimension, according with the following:*
  - *The main manufacturers of magnet wire are global producers with facilities in many countries around the world.*
  - *Customers are mainly multinational companies with local and global purchasing teams.*
  - *Magnet wire imports are significant, around 7% of the total production.*
  - *Some imports to NAFTA are from Asia and other regions, exert considerable competitive constraint in terms of prices and alternative sources of supply.*

Definition of the Relevant Market

cofece

2. Sustitution analysis: geographic dimension

COFECE's arguments

- *COFECE concluded that the geographic relevant market is NAFTA, given the following:*

  - ✓ *Documental evidence presented by the merged entities showed that the only region considered in their commercial strategies was NAFTA.*
  - ✓ *The exports made from Mexico mostly go to US magnet wire producers and the imports mostly came from the United States and Canada.*
  - ✓ *The parties´ argument that an increase of 5% in the magnet wire price would trigger the amount of imports from Asia does not hold up, since they did not considered all the costs involved to keep operation viable.*
  - ✓ *The closeness of the magnet wire supply is a factor that impacts on the application manufacturer's operation, because it represents several costs savings such as low stock, no need to have facilities dedicated to the storage of supplies, timely delivery, lower freights, among others. All of this, reduces the probabilities that the application's manufacturers go to markets outside the region.*

Merger between Rea Magnet Wire Company and Xignux

cofece

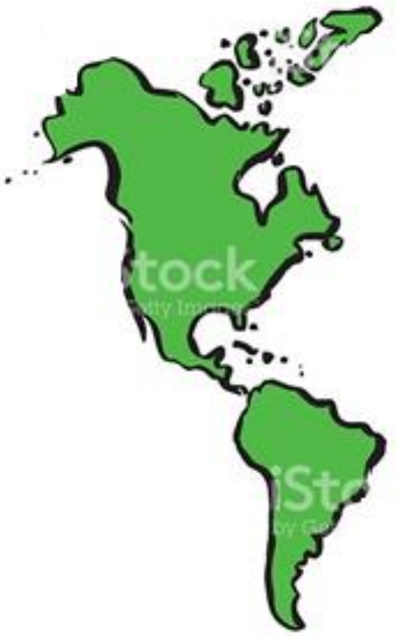
Relevant Market

On the basis of the above, COFECE defined the relevant market as:

The manufacture and distribution of magnet wire in North America.

Overlaps and market shares

Clearly the activities of the notifying parties overlap in the manufacture and distribution of magnet wire in North America.



Market shares

- *COFECE found that the notified transaction would have merged North America's first and third-largest companies, Rea and Xignux, in the production and distribution of magnet wire in North America.*
- *The merged entity would accumulate a significant market share (more than 50%) in terms of both sales and installed capacity.*
- *The Herfindahl-Hirshman index revealed the following:*

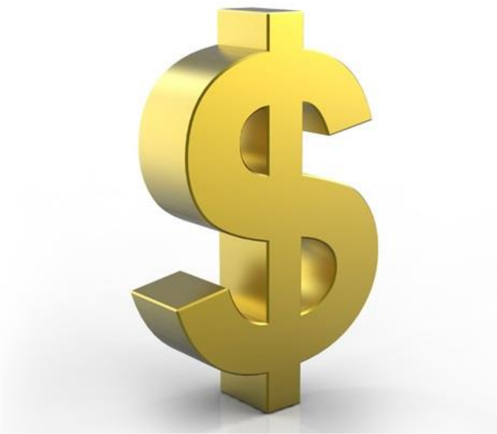
IHH INDEX (in terms of sales)	
Post IHH	**3,874**
Variation	**840**

IHH INDEX (in terms of installed capacity)	
Post IHH	**3,434**
Variation	**589**

According with the COFECE's Concentration Index Criteria, the notified transaction does not meet any of the three technical criteria to consider that the concentration is unlikely to damage, distort or imped effective competition and free market access.

Barriers to entry

Additionally, COFECE found the existence of high barriers to entry and stable participation among current competitors over recent years, as shown bellow:



- *COFECE did not observe the continuous entry of new competitors in the market in North America. At least, since 2010 the market shares of the four main competitors have remained relatively stable.*
- *The required amount and recovery period of the investment to establish a magnet wire plant represent a significant barrier to entry for new competitors.*
- *Magnet wire manufacturers have to approve a standardized process to be a certified provider of magnet wire. This process lasts more than two years, which represents a significant barrier to entry to any potential entrant.*

- *Application's manufacturers do not like to import from other regions such as China. Customers of magnet wire could not substitute their acquisitions with imports from other regions, such as Asia, because this would imply increases in transportation costs, and greater delivery times and logistics risks.*
- *Additionally, imports from other regions imply long waiting periods. For example, the transfer from China to Mexico lasts three months, while NAFTA's transfers last one month.*

Competition concerns

- *In terms of sales, the concentration would represent the union of two of the three main magnet wire producers (the first and the third).*

- *The new entity would have more than the 50% of the market, which will enhance Rea's leadership in the market.*

- *The main magnet wire producers would have more than 80% of the market, therefore it will be unlikely that the competitive fringe could counteract the market power of the new entity.*

- *For magnet wire customers the JV would represent the disappearance of a competitive alternative.*

- *Therefore, it would be likely an increase in prices resulting from the new company.*

The new entity would be in <u>a position of power that would negatively affect free market access</u> and the competition process.

Due to the above, the notified transaction raised competition concerns which could restrict, reduce or impede competition. Thus, COFECE notified those concerns (risks notification) to the merging parties.

Efficiency gains defence

Due to the risks notification from COFECE, the merging parties issued an economic study to prove that the notified transaction would create a more efficient market and therefore improve consumer welfare.
To be considered, efficiencies must accomplished the following elements:

- ✓ *Merger-specific. That is, the efficiencies must be likely to be accomplished with the notified merger and unlikely to be accomplished in the absence of the merger.*
- ✓ *Verifiable. The agencies can verify the likelihood and magnitude of each asserted efficiency.*
- ✓ *Pass-on. The efficiencies must be sufficient to reverse the merger's potential to harm consumer. This is, the efficiencies have to be passed on to consumers, rather than only benefit the merging parties.*
- ✓ *Net-effects: efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.*

- *This means that the efficiency defence will be rejected if equivalent or comparable savings can reasonably be achieved by the parties through other means without the merger's potential adverse competitive effects.*

Efficiency gains defence

EFFICIENCY	MERGING PARTIES CLAIMS	COFECE'S DETERMINATION
	Confidential	

Efficiency gains defence

cofece

EFFICIENCY	MERGING PARTIES CLAIMS	COFECE'S DETERMINATION
	Confidential	

- *Some of the efficiency gains shown by the parties might impact directly in the variable costs, but the merging parties did not prove that this reduction would be transfer to consumers (the pass-on element).*

- *Additionally, the parties did not present evidence to prove that they will not have incentives to absorb the cost reductions adjusting their own margins.*

- *COFECE considered that most of the efficiency gains were not merger specific, since it was possible to achieve the cost savings and reductions in variable costs through alternative actions.*

Remedies

cofece

Proposed remedy

- *The merging parties issued only one remedy in order to address COFECE's concerns.*
- *The proposed remedy was behavioural type, in which the parties undertake to maintain the same commercial conditions with their clients, previous the merger, for a limited period of time.*
- *The purpose of this remedy was to prove that the merged entity will not increase prices to their clients.*

COFECE's argument

- *The remedy proposed by the parties is neither ideal nor sufficient to correct the identified risks, since it is not directly linked to the correction of the merger effects and it is not proportional with the intended correction.*

COFECE's Ruling

COFECE's Ruling

In June, 2017 the Board of Commissioners decided not to authorize the joint venture between Rea Magnet Wire Company and Xignux's, considering COFECE's fundamental responsibility to sanction or block concentrations that may generate risks or anticompetitive conducts.

Thank you

More competition for a stronger Mexico

cofece

Comisión
Federal de
Competencia
Económica