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**GENERAL NOTICES • ALGEMENE KENNISGEWINGS**

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**ECONOMIC DEVELOPMENT DEPARTMENT****NOTICE 847 OF 2015****COMPETITION COMMISSION****NOTIFICATION TO PROHIBIT THE TRANSACTION INVOLVING:****IMERYS SOUTH AFRICA PROPRIETARY LIMITED****AND****ANDALUSITE RESOURCES PROPRIETARY LIMITED****CASE NO: 2015JAN0010**

The Competition Commission hereby gives notice, in terms of Rule 38 (3)(c) of the 'Rules for the Conduct of Proceedings' in the Competition Commission, that it has prohibited the transaction involving the above-mentioned firms:

**Background**

1. On 21 January 2015, the Competition Commission (the "Commission") received notice of an intermediate merger whereby Imerys South Africa (Pty) Ltd ("Imerys South Africa") intends to wholly acquire Andalusite Resources (Pty) Ltd ("Andalusite Resources"). Also relevant for purposes of the proposed transaction is the downstream subsidiary of Imerys South Africa, namely, Calderys South Africa (Pty) Ltd ("Calderys").
2. Imerys South Africa is controlled by Imerys Refractory Minerals Glomel SA ("IRMG"), a firm registered in terms of the laws of France and formerly known as Damrec SAS. The remaining shares are held by the Employee Share Ownership Plan and a black economic empowerment vehicle called Ticamode (Pty) Ltd. IRMG is in turn controlled by Imerys SA ("Imerys"). In South Africa, Imerys, through IRMG, controls various firms.

3. Andalusite Resources is controlled by Andalusite Holdings (Pty) Ltd ("SAAH"). The remaining non-controlling shareholder of Andalusite Resources is Simang Holding (Pty) Ltd and Pilvest Equity (Pty) Ltd. SAAH is controlled by Andalusite Investments (Pty) Ltd ("Andalusite Investments"). Andalusite Investments is in turn controlled by Main Street 939 (Pty) Ltd. The remaining non-controlling shareholder of Andalusite Investments is Investec Bank Limited. Main Street is jointly controlled by The Bain Family Trust and Piet Kolbe. Andalusite Resources does not control any firm.

#### **Areas of overlap**

4. The activities of the merging parties overlap in respect of the mining and supply of andalusite for use in refractories. Specifically, the merging parties' activities overlap in respect of fine and medium grade (0 to 3 mm) andalusite as Andalusite Resources does not mine the coarse grade (above 3 mm) andalusite. There is also a vertical overlap in the activities of the merging parties through Calderys.

#### **Background of the alumina-silicates products**

5. Andalusite forms part of the alumina-silicates group of compounds that include the oxides of aluminium and silicon. Alumina-silicates possess heat resistant properties and are widely used in high-temperature industrial processes e.g. in furnaces, kilns, crucibles and ladles, which require refractories for steel, cement, aluminium, and glass applications. Alumina-silicates are segmented according to the proportion of alumina content (i.e. aluminium oxide  $Al_2O_3$ ) contained in the alumina-silicate. Andalusite sits within the category of products that contain between 55% and 70% alumina, alongside mullite, kyanite and sillimanite.
6. With the exception of andalusite and chamotte, all other alumina-silicates are not mined in South Africa and are imported from countries such as China, France, Brazil, USA, Russia, Australia and Germany. The merging parties are the only miners and suppliers of andalusite in South Africa. The acquiring firm was also the only producer of andalusite in South Africa until approximately 2001 when Andalusite Resources entered the market.

**Relevant product market**

7. The merging parties argue that there is a broad upstream market, including all alumina-silicates.
8. In defining the relevant product market, the Commission considered demand-side substitutability in terms of (i) substitutability between andalusite and other alumina-silicates including the reclaim refractory grog (recycled material) and (ii) substitutability between andalusite and blended alumina-silicates.
9. In its assessment, the Commission found that customers of the merging parties in South Africa do not consider other alumina-silicates as viable substitutes to andalusite for the manufacturing of refractories due to differences in characteristics of the different alumina-silicates. The demand-side substitutability between andalusite and other alumina-silicate is also limited because of a number of factors including:
  - (i) The different chemical and physical properties. For example, andalusite's linear expansion on heating is low. The Commission also found that other alumina-silicates contain high levels of impurities (iron and titania traces) which are unacceptable contaminants in many refractory applications. Andalusite based products are also preferred in some industries such as steel due to the higher creep resistance and thermal stability of andalusite;
  - (ii) Functional substitutability in the different applications. The investigation revealed that within the different applications, alumina-silicates are used to complement each other as opposed to being direct substitutes, due to the different temperature requirements that the alumina-silicates can withstand within the applications; and
  - (iii) The cost of switching to other alumina-silicates. The investigation revealed that other alumina-silicates are not available in South Africa and as such have to be imported. These results in substantial differences in the delivered prices of other alumina-silicates compared to andalusite.

10. The Commission also considered the feasibility of blending other alumina-silicates to produce an alumina-silicate with properties similar to andalusite. Customers submitted that blending of alumina-silicates such as bauxite and chamotte would result in far inferior chemical and physical properties compared to andalusite. Furthermore, the customers contacted are of the view that other raw materials can only be imported and on average, it would cost twice more to import than to source andalusite locally.
11. The Commission also found that the market can be narrowed further according to the size fraction of andalusite that the merging parties are able to mine. Market participants have confirmed that the size fraction of 3 mm to 8 mm andalusite cannot be substituted with other size fractions of andalusite for the following reasons:
  - (i) From a demand-side perspective, the andalusite fractions complement each other and producers of refractories cannot substitute coarser grade andalusite, size fractions greater than 3 mm up to 8 mm, with finer grade fractions ranging between 0 mm to 3 mm; and
  - (ii) From a supply-side perspective, suppliers cannot, in a timely manner, switch to mining coarser grade andalusite if the ore body they are currently mining does not contain coarser crystals.
12. Furthermore, in South Africa, Imerys mines and supplies size fractions of andalusite ranging between 0 mm to 8 mm, whilst Andalusite Resources mines and supplies size fractions of andalusite ranging between 0 mm to 3 mm, as a result, the merging parties pre-merger potentially constrain each other on size fractions of andalusite ranging between 0 mm to 3 mm.
13. The Commission therefore concluded on an upstream market for andalusite with respect to the size fraction ranging between 0 mm to 3 mm (fine to medium grade) for the purposes of analysing the effects of the proposed transaction.
14. The Commission did not conclude on whether the downstream product market of refractory products should be narrowed to separate brick refractory products and



monolithic refractory products but conducted an assessment on the broad market for the manufacture of refractories.

**Relevant geographic market**

15. The merging parties did not conclude on the scope of the geographic market, however, their submissions suggest that the market is international.
16. The Commission found that there have not been any imports of andalusite into South Africa. Other countries that are currently mining andalusite are China, France and Peru. Of the three, Imerys owns andalusite operations in France and China, in addition to their andalusite mining operations in South Africa. All customers contacted confirmed that they do not import andalusite and that it would be costly to do so. Through a simple SSNIP test, the Commission has established that it is unlikely that customers will shift purchases from South Africa to imports from e.g. Peru. As a result, the Commission concluded on a national market.
17. Similarly, the Commission found that there are no imports of andalusite based refractory products and that customers are limited to the local market as a source of supply for these products. The Commission therefore considered a national market for the downstream manufacture of refractory products.

**Competitive assessment: Unilateral effects**

18. In its assessment of unilateral effects, the Commission considered (i) closeness of competition between the merging parties, (ii) barriers to entry, and (iii) countervailing power.
19. In assessing closeness of competition, the Commission considered evidence based on the following:
  - (i) Market share analysis. The Commission concluded that the proposed transaction will result in the removal of an effective competitor in the market for the mining and supply of fine and medium grade andalusite, as Andalusite Resources has had the ability to capture sales lost by Imerys South Africa over the observed period, and *vice versa*;

- (ii) Qualitative analysis based on customer submissions. Customers consider the merging parties to be close competitors and have either switched from Andalusite Resources to Imerys South Africa or Imerys South Africa to Andalusite Resources for the following reasons: (a) limit on requirements that could be sourced from one of the merging parties (b) prevailing prices such that the customers consider switching to the alternative supplier with lower prices; and (c) unsatisfactory quality. It is evident from customer submissions that there was a large diversion of purchases from Imerys South Africa to Andalusite Resources, particularly during the period 2012 onward when Andalusite Resources had sorted its “quality issues”;
  - (iii) The merging parties internal documents such as strategy document and business plans.
20. Given the above, the Commission is of the view that the proposed transaction will result in the removal of an effective competitor in the market for fine and medium grade andalusite.
21. The Commission considered the countervailing power of customers. In assessing this, the Commission considered evidence based on the following:
- (i) Availability of alternative sources of supply in order to assess whether or not the customers could credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply (such as imports). The Commission found that there are no alternative sources of supply apart from Andalucita S.A. based in Peru. The customers and a simple SSNIP test confirm that it is not economically feasible to import andalusite into South Africa; and
  - (ii) Price formation process. The investigation revealed that suppliers of andalusite are price setters in this market whilst the refractory producers are price takers with limited, if any, negotiating ability. The Commission understands that with the exception of two domestic customers, other domestic customers do not have

supply agreements with suppliers of andalusite. Even in instances where customers have supply agreements with the merging parties, the agreement is for a short duration. This may not be enough to discipline the merged entity post-merger.

22. For these reasons, the Commission is of the view that customers do not have the countervailing power to discipline the merged entity should it behave anti-competitively post-merger.
23. In its assessment of barriers to entry, the Commission considered whether new entry would be likely, sufficient and timely in order to constrain the merged entity post-merger. The Commission identified the following barriers to entry: (i) regulatory requirements; (ii) access to deposits; (iii) capital requirements; (iv) technical know-how; and (v) access to a customer base.
24. The Commission found that barriers to entry into the market for the mining and supply of andalusite are relatively high. This is because the capital requirements, regulatory requirements and access to deposits are significant, making entry unlikely. In addition, a potential entrant would have difficulty in accessing andalusite deposits and reserves.
25. The investigation further revealed that the technical know-how and the technology are critical in the mining and production of andalusite. It took Andalusite Resources approximately 10 years for it to be considered an effective competitor, which happened as soon as the levels of impurity within its andalusite products were within ranges acceptable to customers.
26. Taking the above into consideration, the Commission is of the view that the proposed merger is likely to substantially prevent or lessen competition in the market for the mining and supply of andalusite, through the likelihood of unilateral effects that may arise as a result of the proposed merger.

**Competitive: Vertical assessment**

27. In its vertical assessment, the Commission considered whether the merged entity has: (i) the ability to engage in an input foreclosure strategy and (ii) the incentive to engage in an



input foreclosure strategy. Further, the Commission also considered whether the vertical integration would have the effect of lessening competition in the downstream market.

28. The proposed transaction constitutes a merger to monopoly. As a result, the merged entity's customers would have no alternative sources of andalusite and are thus solely reliant on the merging parties for the supply of andalusite. There would be no effective competitive constraints that will discipline the merged entity should prices increase as a result of the proposed merger.
29. A common feature in the upstream market, for both Andalusite Resources and Imerys South Africa, is that export prices are higher than domestic prices. Thus the merged entity would have an incentive to engage in an input foreclosure post-merger, as such a strategy would result in higher profits upstream. This however will only be the case if there is sufficient demand in the export market enabling the merged entity to reallocate volumes from the domestic market to the export market. The merging parties submitted that there is an increase in export opportunities and that they are currently reallocating volumes to the export market to the extent possible. However, there was no sufficient evidence submitted in support of these export opportunities.
30. The Commission also considered whether the merged entity would be able to increase profits in the downstream market as a result of engaging in input foreclosure. The investigation revealed that Calderys, the downstream arm of Imerys, has been producing above capacity for the period under observation. Calderys's capacity utilisation implies that Calderys would not have the ability to absorb the downstream refractory demand, should its competitors be driven out of the market. However, the Commission found that it is likely that Calderys would increase its capacity, thus potentially increasing the incentive of the merged entity to engage in input foreclosure.
31. The Commission is of the view that the input foreclosure strategy of the merged entity would have an adverse effect on competition downstream. The exit or weakening of Calderys' competitors would be detrimental to consumers as the foreclosure of andalusite would give rise to an upward pressure on prices of refractories. End-users may be forced to alter their production processes which may also result in price increases of the final industrial products that require refractories in their production processes.



32. In terms of customer foreclosure, there are no competitors upstream (in SA, excluding imports) that can be excluded from having Calderys as a customer. As a result, no assessment of customer foreclosure was conducted.
33. Taking the above into consideration, the Commission is of the view that the proposed merger is likely to lead to input foreclosure concerns.

**Efficiencies and other pro-competitive gains**

34. The merging parties advanced efficiencies relating to: (i) improved marketing, research and development and application development on an international scale; (ii) the optimisation of sales channels to market and the optimisation of international logistics; (iii) access to increased capital for Andalusite Resources; and (iv) the sharing of know-how and expertise, among others. The Commission is of the view that the efficiencies submitted by the merging parties are not measurable which made it difficult to ascertain whether they are real, verifiable and would eventually be passed on to consumers.
35. However, it is evident from the Commission's findings that Andalusite Resources has been performing well, is more efficient and growing in the market and is thus a competitive constraint to Imerys South Africa. For example, currently Andalusite Resources has managed to increase its quality offering and compete vigorously with Imerys South Africa on its own and has also been able to successfully enter the export markets.

**Public interest assessment: Effect on employment**

36. The merging parties anticipate that a total of 20 employees which represent 3.6% of the work force are likely to be retrenched as a result of the proposed merger. The Commission engaged with the trade unions of the merging parties' employees, United Association of South Africa ("UASA") and the National Union of Mineworkers ("NUM") and received concerns from both unions. The merging parties engaged with UASA and NUM to resolve concerns in this regard.

37. However, should there be any other employment concerns that remain, the Commission is of the view that these will not materialize if the proposed merger is prohibited, on the grounds that it substantially prevents or lessens competition.

**Public interest assessment: Effect on impact on a particular industry or sector**

38. The steel industry consumes the vast majority of alumina-silicate based refractories. Alumina-silicate based refractories are also consumed in the industrial minerals applications, such as casting, abrasive, and ceramic applications. In terms of the proportion of andalusite on the production costs, customers estimate that andalusite accounts for approximately 20% - 50% of their total cost of production. For the manufacturers of refractories, approximately 30% to 78% of their products are andalusite based. The Commission gathered that andalusite based refractories account for approximately 3% of the total production costs for end-users.
39. The Commission's concern is that end-users in steel, glass and cement are important contributors to the South African economy and provide important inputs in other sectors of the economy, such as in construction. The likely price increases from this merger will directly affect the customers (producers of refractories) and end-users, who will simply pass on the price increases or be forced to consider costly alternatives such as imports, or to even exit the market.
40. Therefore, the likely effect on the producers of refractories, the end-users and other related sectors is likely to be substantial.

**Public interest assessment: Effect on ability of national industries to compete in international markets**

41. The Commission is of the view that the merging parties have failed to provide evidence on how the proposed transaction would enable them to become more competitive globally given that they are currently the main players (particularly Imerys) in the global

market for andalusite. Further, given that the proposed merger would lead to a substantial prevention or lessening of competition in the domestic market, as discussed above, as well as the importance of andalusite as an input product for the customers of the merging parties, the Commission is of the view that there are no pro-competitive benefits for the

relevant sector that outweigh the likely anti-competitive effects of the proposed transaction.

#### **Concerns received**

42. The Commission received concerns from both the producers of refractories and end-users. In summary, the producers of refractories are concerned that there are no pricing and supply agreements for most customers of the merging parties and as such there is no supply and price guarantee post-merger. Producers of refractories are further concerned that Imerys South Africa has previously reduced its volume allocation for andalusite to local customers and increased its pricing significantly as part of its then strategy to divert local supplies to exports. The merger is also likely to make it uncompetitive for the domestic producers to competitively export their refractories. Further, producers of refractories are concerned that the proposed transaction removes competition as there will be no alternative supplier of andalusite locally, post-merger.
43. End-users are concerned that the proposed transaction will not only affect the producers of refractories but also the end-users, as producers of refractories pass on the price increases to end-users. The end-users will have a difficulty switching from the use of andalusite based products to other applications as the andalusite based refractories outperform other alumina-silicate based refractories and there are costs associated with switching.

#### **Proposed remedies by the merging parties**

44. In response to the concerns raised, the merging parties proposed a supply condition limited to two to three years for all grades of andalusite other than coarse grade. The supply would be limited to the annual volumes which are at most equal to the annual purchases by the customer in question over the last twelve months at the prices already agreed with each customer for 2015. Further, after expiry of the three years duration, volumes purchased will be subject to new prices and/or prices prevailing in the market at the time of the purchase.
45. The Commission tested the proposed remedies with customers that were contacted during the investigation. Some customers considered the remedies to be sufficient while

most are sceptical about the remedies. The customers' general view is that the merger should not be allowed as it is not in the interest of South Africa and that it will result in a monopoly in South Africa. The prevailing market prices post the 3 year period is also likely to be high as, in any case, the merging parties are the only producers of andalusite in South Africa and thus price leaders.

46. The Commission is of the view that the removal of Andalusite Resources as an effective competitor would not be remedied post-merger through the conditions proposed by the merging parties. The investigation by the Commission has shown that barriers to entry are high and there are no prospects of timely entry. The Commission is of the view that the structural changes in the market brought about by the proposed transaction are not addressed by the proposed remedy.

### **Conclusion**

47. The Commission concludes that the proposed transaction is likely to lead to a substantial prevention or lessening of competition in the relevant market. There is no evidence of any pro-competitive or public interest benefits that may arise as a result of the proposed transaction that will outweigh the anti-competitive effects as identified.
48. Accordingly, the Commission prohibits the proposed merger.

Enquiries in this regard may be addressed to Manager: Mergers and Acquisitions Division at Private Bag X23, Lynnwood Ridge, 0040. Telephone: (012) 394 3298, or Facsimile: (012) 394 4298.