

**COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA**

Case no.: 03//LM/Jan06

In the large merger between:

International Mineral Resources AG

and

Kermas South Africa (Pty) Ltd

Reasons

Introduction

On 20 April 2006 the Competition Tribunal unconditionally approved the merger between International Mineral Resources AG and Kermas South Africa (Pty) Ltd. The reasons are set out below.

The transaction

International Mineral Resources AG ("IMR") is acquiring 32.5% of the issued shares in Kermas South Africa (Pty) Ltd ("Kermas SA") including certain rights that will enable IMR and Kermas to jointly control Kermas SA and consequently Samancor Chrome.¹

IMR, whose principal business is in Switzerland, controls Eurasian Natural Resources Corporation ("ENRC") which owns TNC KazChrome JSC ("KazChrome"). KazChrome is active in the mining of ferroalloys and owns two mines in Kazakhstan. It does not own any mines in South Africa.

The target firm, Kermas SA, is a wholly owned subsidiary of Kermas Ltd ("Kermas"), a company incorporated under the laws of the British Virgin Islands.

¹ The parties informed the Tribunal that some shares would be transferred to a BEE shareholder subsequent to this transaction in order to facilitate compliance with the BEE Mining Charter and that they will notify the transaction in terms of the Competition Act should the BEE transaction effect a change in control.

Mrs Danica Zagmester of Croatia owns 82% of the total issued shares of Kermas. Kermas SA controls Samancor Chrome, which owns chrome mines in Mpumalanga, Limpopo and North West Provinces.²

Rationale for the transaction

The merging parties claimed not to have any business plan with regard to the future strategies of their respective companies.

According to IMR this transaction poses an investment opportunity which also allows IMR, by operating in the two main chrome producing areas Kazakhstan and South Africa, to stabilise its income and minimise the risk attached to currency fluctuations.³

From Kermas' side the transaction will afford Samancor, which is one of the highest cost producers in South Africa, access to more cost effective technology.⁴

Relevant market

Both IMR and Samancor are vertically integrated ferrochrome producers. IMR owns two chrome mines in Kazakhstan and Samancor various chrome mines in three different provinces in South Africa, namely Mpumalanga, Limpopo and North West Province.

The Commission identified two relevant markets, an upstream market defined as the national market for the mining of chrome ore and a downstream global market for the production and supply of ferrochrome.

Chrome ore is generally mined as a primary product. It is further processed into four different grades of chrome namely metallurgical, chemical, foundry and refractory grade chrome. The processing is always done close to the mine due to high transport costs. Metallurgical grade chrome, which accounts for 90% of the total chromium consumption, is used in the production of ferrochrome, a metal alloy consisting of chrome, iron and carbon, with traces of sulphur and phosphorus. Ferrochrome is the critical alloying ingredient in the production of stainless steel, making up 10% or more of the final composition. It improves the hardness and resistance to corrosion and oxidation in stainless steel.

² The Tribunal approved this transaction in 2005, see Tribunal Case no: 22/LM/Mar05

³ See transcript page 88.

⁴ See transcript page 53.

Although there is no official industry classification, different grades of ferrochrome are identified depending on the chrome ore used and the carbon content thereof. These are however considered by the parties as substitutable:

- ?? Charge chrome: It contains between 48-55% chrome and 6-8% carbon and is mainly used in the production of stainless steel. Samancor and its South African competitors are major suppliers in this segment.
- ?? High Carbon Ferro Chrome: It contains over 60% chrome and 7-8% carbon and is mainly used in the production of alloy steel other than stainless steel. KazChrome is the leading producer in this field.
- ?? Intermediate and low carbon ferrochrome: It contains less than 4% carbon and is used in nickel alloys and a wide range of special steels, including stainless steel. Both Samancor and KazChrome supply low and medium carbon ferrochrome.

Chrome units contained in stainless steel scrap are also refined and used as a substitute for ferrochrome. However Columbus Stainless (Pty) Ltd (“Columbus”) indicated that in South Africa it is not regarded as a viable substitute since only a limited quantity is available. It is also not cost effective to import scrap metal for this purpose.⁵

The merging parties’ largest competitors in South Africa are, inter alia, Xstrata, Heric Ferrochrome and Assmang, all of which are vertically integrated ferrochrome producers. There is only one ferrochrome customer located in South Africa, Columbus Stainless. Accordingly very little of the South African production of ferrochrome (10%) is used locally and the balance (90%) is exported.

Market shares

The mining of chrome ore

The 2005 market shares in the national market for mining chrome ore are:

	<u>2005</u>
Samancor	37%
Xstrata	30%
Ore and Metal	12%
ASA	4%
Other	<u>17%</u>
Total	<u>100%</u>

⁵ See transcript page 28.

There is no change in the market share of Samancor in the national market for the mining of chrome ore since KazChrome does not own chrome mines in South Africa.

The production and supply of ferrochrome

The 2004⁶ market shares in the market for the global production and supply of ferrochrome are:

	<u>2004</u>
Xstrata	21.6%
KazChrome	13.6%
Samancor Chrome	11.7%
China	9.2%
Outokumpu (Finland)	4.0%
Hernic Ferrochrome	3.8%
Assmang/Ferrolloys	3.5%
Chelyabinsk (Russia)	2.9%
Kermas	2.6%
Facor (India)	2.2%
DLA (USA)	1.5%
Others	<u>23.4%</u>
Total	100%

Post the transaction the merged entity will become the largest global competitor with a market share of 28% and Xstrata will drop to second place with a market share of 21%.

The Competition Commission calculated the post merger HHI as 1803.80 with a delta of 318, indicating that this is a highly concentrated market, which could raise competition concerns.⁷

Competitive Assessment

Horizontal effect of the transaction on the production and supply of ferrochrome

In determining whether this merger is likely to substantially prevent or lessen competition in the concentrated ferrochrome market the Tribunal considered whether it would be easy for new entrants to enter the market when prices increase, the degree of buyer or countervailing power, availability of excess capacity and price transparency and exchange of information.

⁶ According to the parties these are the most recent published figures.

⁷ According to the US Horizontal Merger Guidelines, post merger HHI above 1800 depicts a highly concentrated market. If the increase in the concentration ratio (the delta) is more than 100 points the transaction could raise competition concerns.

Excess capacity

Coordination is less likely if competitors and fringe producers can increase output substantially in response to an increase in price by the merging firm.⁸ According to evidence presented to the Tribunal existing producers of ferrochrome, such as Xstrata and Hercul, could expand their production of ferrochrome quite quickly because they have sufficient idle production capacity. Xstrata, the lowest cost ferrochrome manufacturer in South Africa recently announced plans to boost its chrome ore production by utilizing cost-efficient UG2 chrome ore, a by-product of platinum production. It is also constructing three new furnaces.⁹ According to Hercul it has sufficient ore to expand to four times its current size.

Although scholars warn that excess capacity could also enable competitors in a cartel to punish a firm that cheats by flooding the market and forcing prices down, this is less likely in an expanding market, such as the growing steel market than a mature and stable market, because it is not so easy to spot deviations and punish them.¹⁰

Barriers to entry

Ease of entry usually acts as deterrent for price increases. We were informed that barriers to entry are higher for greenfield entry, i.e. entry by new players, due to regulatory barriers than for brownfield entrants which are low.¹¹ Companies regularly enter and exit the market or open and shut down production facilities, depending on the current price level.

The strong demand for steel in China, which is expected to continue in the next few years, makes expansion currently more attractive. This is exactly what happened with toll producers in China and India in 2005. Hercul avers that should the prices of ferrochrome increase, other toll converting producers will enter the market quickly, for example China and India have facilities that could switch easily between manganese, silica and chrome. Chinese capacity increased 100% because of high ferrochrome prices and this led to a price decrease in the last two quarters of that year. Thus, when market conditions are favourable these producers will simply switch to chrome and start producing ferrochrome immediately.¹²

Ferrochrome Prices

Ferrochrome prices are set internationally on a quarterly basis via negotiations between producers and customers and are published in, for example the Metals Bulletin. These publications only indicate rough estimates of prices as

⁸ See Antitrust Law IV by Areeda, Hovenkamp, Solow, page 216

⁹ See the merger information filed by the parties with the Federal Cartel Office Germany.

¹⁰ See Massimo Motta Competition Policy Theory and Practice page 146.

¹¹ Greenfield entry refers to new entrants to a market and brownfield to competitors who re-enter a market which they had previously exited.

¹² Record page 51.

confidential volume discounts, ranging between 5-10%, are negotiated between suppliers and their customers, thus eliminating the possibility of price transparency and therefore collusion.¹³

Ferrochrome is mostly purchased via long term supply contracts, with suppliers and customers negotiating volumes annually and prices quarterly. In Europe ferrochrome prices are constrained by stainless steel scrap, which is abundantly available in Europe, and therefore acts as a competitive constraint on ferrochrome suppliers.

Although stainless steel scrap is not abundant in South Africa and not regarded by Columbus Stainless as a substitute, it does indirectly affect the price that Columbus Stainless pays for its ferrochrome, since its long-term ferrochrome supply agreement with Samancor includes a price formula based on the European price of ferrochrome lump¹⁴ less the pipeline cost (i.e. transport cost) which is the delivered price to Middelburg.¹⁵ Accordingly if the price of ferrochrome is 60 cents in Europe, Columbus will pay 60 cents minus the pipeline cost of 10 cents because they have the benefit of being close to Middelburg where Samancor is located. If the price in Europe increases by 5 cents the local price will also increase by 5 cents because it is an international market.

Samancor is Columbus Stainless' main supplier, supplying approximately 80% of its ferrochrome, however it also buys spot tonnages on an annual basis on the open market of between 30 000 to 40 000 tonnes, normally at a price lower than the reference price.¹⁶

According to Hernic smaller producers are price followers.¹⁷ Large producers such as Xstrata and Samancor would negotiate quarterly prices with the large stainless steel producers in Europe. Although the market is characterised by a number of very large players these producers have never, according to Hernic, been able to dominate the market because smaller producers, such as Hernic, react very quickly to an increase or decrease in the reference price.

Hernic, who regards itself as a new entrant, has managed to increase its market share during the past 10 years since it started and is regarded by players such as Samancor as somewhat of a maverick in the market, undercutting prices to gain long-term contracts.¹⁸ Hernic avers that there are too many small

¹³ See footnote 9 supra and also transcript on page 87.

¹⁴ This price represents the European price that Acerinox, Samancor's parent company in Spain, negotiates quarterly with Samancor in Europe. According to Samancor ferrochrome producers always negotiates prices with representatives of a group rather than with individual companies within the group.

¹⁵ The supply agreement ends in 2007.

¹⁶ According to Columbus Stainless it has reduced the tonnages that it buys from Samancor from 100% to 80% and lower in recently.

¹⁷ See transcript page 36.

¹⁸ See record page 117, Samancor Business Plan - confidential document. Also see transcript on page 48.

ferrochrome producers globally that would undermine prices rendering the market too unstable for effective price collusion.

Countervailing power

According to HERNIC the price of ferrochrome is driven to a large extent by the large stainless steel producers in Europe.¹⁹ Moreover, although a general reference price is negotiated quarterly secret discounts are negotiated between ferrochrome producers and each of their large stainless steel customers on an individual basis frustrating the possibility of collusion even more. Customers can also switch easily to other ferrochrome producers if the parties do not agree on price or to scrap metal, as is the case in Europe, without any adjustment to their production process.²⁰ This suggests that large buyers have countervailing power.²¹

Conclusion

Although the ferrochrome market is highly concentrated we find that it is unlikely that the merged entity will behave anti-competitively or co-operatively since entry barriers are low, surplus capacity exists, prices negotiated between producers and customers are not transparent because of secret discounts and large buyers with countervailing power are present.

Vertical effect of the transaction

Local producers of ferrochrome are all vertically integrated and the merger is therefore unlikely to raise any foreclosure concerns.

Public interest issues

The transaction will have no effect on any public interest issues.

Y Carrim

13 June 2006
Date

Concurring: N Manoim, M Mokuena

¹⁹ See transcript page 47.

²⁰ See transcript page 18–21 and 51.

²¹ The likelihood of non-competitive pricing is curtailed when sophisticated large buyers, making large purchases, are present. See Areeda Hovenkamp and Solow *Antitrust Law IV* page 201.