COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case no.: 109/LM/Nov05

In the large merger between:

Chemical Services Limited

and

Leochem (Pty) Ltd

Reasons

Introduction

1. On 17 February 2006 the Competition Tribunal approved the merger between Chemical Services Ltd and Leochem (Pty) Ltd. The reasons are set out below.

The transaction

2. Chemical Services Ltd ("Chemserve") intends to acquire Leochem (Pty) Ltd ("Leochem") as a going concern. Leochem will be merged with Chemserve subsidiary Akulu Marchon (Pty) Ltd. Its food phosphate division will be absorbed by Lake International Technologies (Pty) Ltd, a subsidiary of Chemserve.

3. Chemserve is controlled by AECI Ltd, a public limited company listed on the JSE. No one shareholder directly or indirectly controls AECI. Its five largest shareholders are:

Coronation Asset Management	18.9%
RMB Asset Management	17.1%
Old Mutual Asset Management	10.3%
Stanlib Ltd	9.8%
Bernstein Investment Research Management	6.1%

4. Two shareholders control Leochem, namely:

Sandy Rae Family Trust	50%
Ashley McNabb Family Trust	50%

5. Leochem, which owns depots in Cape Town, Durban and Johannesburg, does not directly or indirectly control any other firm.

Rationale for the transaction

6. Chemserve views the acquisition of Leochem, whose current shareholders wish to exit the business, as an opportunity to expand and complement its current product offerings.

Relevant Market

7. The merger has horizontal as well as vertical effects. Both Leochem and Chemserve manufacture and distribute chemical products and also act as third party distributors of imported chemical products.

8. The horizontal overlap concerns two chemical products which are manufactured and distributed by a subsidiary of Chemserve, IOP, and which is also imported and distributed by Leochem, namely distilled tall oil and gum rosin. The vertical effect pertains to products that Leochem manufactures and which are sold as input products to two Chemserve subsidiaries, Plaaskem and Crest, namely petroleum jelly and light white oils.

9. According to the parties the size of the market for independent or third party chemical distribution is estimated to be approximately R4 billion, which represents approximately 15% of all chemicals distributed in South Africa. Most manufacturers, approximately 85%, distribute their own product.

<u>Horizontal product markets</u>

10. As indicated above Chemserve and Leochem do not manufacture the same chemical products. They do however distribute the same chemicals, two of which concern us because of high market shares post the transaction namely distilled tall oil and gum rosin.[1]

11. IOP is the only manufacturer in South Africa that produces a range of distilled tall oil products, which are used as a base product in the production of certain lubricants. The particular distilled tall oil that IOP

[1] The other products are: tall oil fatty acids, rubber tackifier, pinerez, cetostearyl alcohol, polysorbate, glyseryl monostearate, phosphates, glycerine and potassium hydroxide.

manufactures, called R30-5, has a 30% rosin content and overlaps with a similar product imported and distributed by Leochem, known as PC300. Leochem sources its product on the international market from Akzo Nobel. An import duty of 10% is imposed on imports. The parties estimate that this product constitutes between 4% and 15% of the total input costs of downstream customers.

12. IOP also taps crude gum from living pine trees in South Africa and then refines the gum rosin at its plant in Durban. Gum rosin is used in the adhesive industry and is also used as a base building block for various resins. Leochem currently imports all its gum rosin. There are no import duties on this product.

<u>Vertical product markets</u>

13. Leochem manufactures petroleum jelly, blends white oils and also imports certain chemical products, all of which are supplied to various AECI subsidiaries and other customers. Approximately 50% of Leochem's turnover is derived from the manufacture and distribution of petroleum jelly, while 25% of turnover is derived from the blending and/or distribution of imported white oils at its Durban plant. The remaining 25% of revenue is derived from the import, supply and distribution of other chemical products.

14. Petroleum jelly is a by-product of the refining of petroleum and is used in the pharmaceutical, cosmetic, printing ink, leather and rubber industries. Leochem sells petroleum jelly to Chemserve Systems, which uses it in the production of waterless hand cleaner.

15. Leochem imports all its white oils of which approximately 60% are then blended according to customer specification at its blending facilities while the balance of 40% is sold as-is. White oils are produced as a by-product in the distillation of gasoline from crude oils and are used as a blending base in the manufacturing of personal care and pharmaceutical products, plastics and in food applications.[2] Leochem does not have any exclusive supply agreements with any of its international suppliers.

16. Plaaskem, a subsidiary of AECI, uses liquid paraffin and light white oil in the production of anti-parasitic products used in the veterinary industry. Plaaskem itself does not compete in the market for veterinary products but is merely contracted to produces the products on behalf of Intervet (Pty) Ltd.

17. We will thus consider the vertical effects of the transaction on:

[2] White oil is also known as White Mineral Oil, Mineral Oil, Liquid paraffin, Paraffin Oil, Vaseline Oil, liquid petrolatum or wax oil.

1) The upstream market for the manufacture of petroleum jelly and the downstream market for the manufacture of industrial hand cleaners, and
2) the upstream market for the manufacture of light white oils and/or liquid paraffin and the downstream market for the manufacture of anti-parasitic products.

18. The geographic markets identified in the horizontal and vertical product markets are all national.

19. We will first analyse the horizontal effect of the transaction on competition and then the vertical effects.

Effect on competition

Horizontal effect on competition in the Distilled Tall Oil product market

20. Post the transaction the merged entity's market share will increase with 33% to approximately 83% in the market for the distribution of distilled tall oil. It should, however, be noted that IOP's market share of 50% pre-merger includes all the distilled tall oil produced by IOP and not only the product R30-5 that overlaps with PC300 which is imported by Leochem. The post-merger market share of 83% is thus not a true reflection of IOP's market share in the narrow relevant product market.

21. Import barriers are low, the import duty is 10%, and the product can be imported from large international competitors such as Akzo Nobel (Netherlands), Arizona Chemicals (USA), Harima (Japan) to name but a few. According to the parties imports currently constrain the pricing of IOP in South Africa. This is illustrated by the fact that Leochem, IOP's largest competitor of distilled tall oil, managed to import the product and compete successfully with it.

22. IOP does not only sell R30-5 directly to its own customers but also sells a large quantity of this product, on a non-exclusive basis, to independent chemical traders/wholesalers such as Chemical Industrial Marketing ("CIM") and Protea Chemicals. During April to December 2005, 22.9% of IOP's total sales of distilled tall oil were sold to CIM and 9.4% to Protea. Approximately 64% of sales were direct sales to end customers.

23. As stated above Leochem imports all its distilled tall oil from Akzo Nobel. Distilled tall oil represents 0.7% of its total turnover and it does not have any formal supply agreement with Akzo Nobel or with any downstream customers. It imports it on an ad hoc basis as and when the need arises.

24. According to the Commission’s market inquiry it appears that by virtue of IOP being the sole manufacturer of distilled tall oil in the country it is inevitable that IOP would have high market shares in the distribution of the product. To some extent, imports, especially those by Leochem, appear to have disciplined IOP’s pricing policy. Therefore, it is the contention of market participants who use distilled tall oil that the transaction will result in the removal of an effective competitor from this market.

25. In our view the merger does not result in a substantial lessenin of competition in the narrow product market of R30-5/PC300. In the first instance Leochem is an importer not a manufacturer. The merger will not relax the current constraint on IOP’s pricing, which is the global price of the product. Moreover, other distributors of chemical products, such as Chemimpo, CJH Petrow and Protea Chemicals have confirmed to the Commission that they could import distilled tall oil should there be a need in the local market thus suggesting that entry barriers are low.

<u>Horizontal effect on competition in the Gum Rosin product market</u>

26. The market shares of IOP, which manufactures gum rosin, and Leochem, an importer, for the distribution of gum rosin are 30% and 10% respectively. Post the transaction the merged entity will have a market share of 40%.

27. The Commission found in its investigation that gum rosin is imported duty free and with relative ease. The largest producer of gum rosin is China with other large producers being Indonesia, Thailand and Brazil. The product is freely available on the world market and there are numerous traders selling the product locally. There have also been imports of gum rosin by direct users such as Pekay Chemicals, Plascon Paints and Quialichem. Another company indicated to the Commission that it imports the majority of its gum rosin requirements from its sister company based overseas. Local distributors such as Protea Chemicals, C.J. Petrow Chemicals, Carst and Walker and Daytona Chemicals also supply gum rosin.

28. IOP’s production has decreased from approximately 300 tonnes per month in 2002 to 40 tonnes per month currently. The reason for this, according to the parties, is that the South African trees are drying up. This has resulted in an increase of imports in gum rosin to supplement local production.

29. Leochem currently imports all its gum rosin from Akzo Nobel.

30. In light of the fact that imports are increasing, various alternative importers of the product exist and entry barriers are low, we agree with

the Commission that the merger would not substantially prevent or lessen competition in this relevant market.

<u>Vertical effect on the upstream market for the manufacture of petroleum jelly and the downstream market for the manufacture of industrial hand cleaners</u>

31. As indicated above Leochem is a manufacturer of petroleum jelly. Chemserve sources its total supply of petroleum jelly from Leochem, and uses it as an input product in the manufacturing of waterless hand cleaner. Chemserve consumes less than 1% of the total production of petroleum jelly.

32. Leochem's market share in the upstream market is 55%. Its main rivals in the upstream market are H&R Wasag and a new entrant PFP with 30% and 10% market share respectively. PFP entered the market approximately 6 years ago. Wasag has been in the market for 20 years.

33. Chemserve's market share in the downstream market is approximately 1%. In light of the insignificant volume of petroleum jelly consumed by Chemserve as well as the presence of other manufacturers we agree with the Commission that customer foreclosure is unlikely.

<u>Vertical effect on the upstream market for the manufacture of light white oils and/or liquid paraffin and the downstream market for the manufacture of anti-parasitic products</u>

34. There are no local producers of light white oils and liquid paraffin in South Africa. Leochem imports all of its white oils and blends 60% of it according to customer specifications. The white oils, liquid paraffin and light white oil, are imported by Leochem and sold to Chemserve's subsidiaries, Plaaskem and Crest, as is. Plaaskem and Crest sourced all of its requirements from Leochem.

35. In the first upstream market of liquid paraffin, Leochem is the second largest player with a market share of 30%. Its largest rival, Engen, has a market share of 40%. There are two other players, OCC/PFP and Orbichem each with a market share of 10%.

36. In the second upstream market, the market for light white oils, Leochem has a market share of 60% and Engen, the second largest player a market share of 20%. The remaining player, OCC/PFP has a market share of 10%. In the downstream market Crest is a third party trader in chemical products. It buys and sells a large range of products and is unable to determine its market share on a product basis. Its market share, in the broad market for the distribution of chemical products, is approximately 10%.

37. In the downstream market Plaaskem uses the light white oil and liquid paraffin to produce anti-parasitics used in the veterinary industry. It sells the products to Intervet (Pty) Ltd whose market share varies between 14%-23% depending on the product.

38. Plaaskem is not Leochem's largest customer. Bayer, an international company with a longstanding relationship with Engen, bought 24 times more liquid paraffin than Plaaskem. Bayer confirmed to the Commission that there are alternative sources locally as well as overseas from which it can feasibly source paraffin and/or light white oils. According to the Commission it is not economical to start a manufacturing plant for light white oils in South Africa. The domestic market would thus continue to import because barriers to entry for importing and blending are relatively low.[3]

39. We therefore find that input and customer foreclosure are unlikely in any of the vertical markets. We accordingly find that the transaction will not substantially prevent or lessen competition.

Public interest issues

40. Three employees, all of them directors of Leochem, face the risk of being retrenched. Since they are highly skilled persons the likelihood of them finding alternative employment is high in the event of them being retrenched.

41. The merger is approved unconditionally.

22 February 2006

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Y Carrim **Date**

Concurring: U Bhoola and M Mokuena

[3] It would cost approximately R500 000 to set up an entry level blending facility