

IN THE COMPETITION TRIBUNAL OF SOUTH AFRICA

CASE NO.: 13/LM/JAN08

In the merger between:

Scaw South Africa (Pty) Ltd

Primary Acquiring Firm

and

Ozz Industries (Pty) Ltd

Primary Target Firm

Panel : D Lewis (Presiding Member), Y Carrim (Tribunal Member), and U Bhoola (Tribunal Member)

Heard on : 30 May 2008

Order issued on : 4 June 2008

Reasons issued on : 21 July 2008

REASONS FOR DECISION

APPROVAL

[1] On 4 June 2008 the Tribunal conditionally approved the merger between the aforementioned parties.

THE MERGING PARTIES

[2] The primary acquiring firm is Scaw South Africa (Pty) Ltd ("Scaw"), a subsidiary of Anglo American. The primary target firm is Ozz Industries (Pty) Ltd ("Ozz"), which is not controlled by any firm.

THE TRANSACTION AND RATIONALE

[3] This transaction involves an acquisition by Scaw, of the entire issued share capital of Ozz in terms of the Sale of Shares Agreement signed by both parties. In terms of this agreement, Scaw will have sole control of Ozz, with the exception of Ozz's West Rand

Engineering Division as well as its subsidiaries; Klambon Water (Pty) Limited and Natal Steam Coal (Pty) Limited, which will be retained by the current shareholders of Ozz.¹

[4] For Scaw, this transaction is an opportunity to optimize its synergies and increase production in particular in the production of high chrome grinding media, which will be achieved by utilizing Ozz Industries' West Disa Plant which is currently used to produce cheek plates for West Rand Engineering ("WRE"). This will be conveyed to Scaw Union Junction plant for *heat treatment*, a facility which Ozz Industries currently does not have.² Scaw's objective is to implement stricter health and safety standards and environmental regulations at Ozz Industries' foundries.³ For Ozz Industries' private equity investors, the proposed transaction is an opportunity to realize their investment.

RELEVANT MARKET

[5] Scaw's group has four main product lines which are: rolled products; cast products; grinding media and wire rod products. Ozz is active in the manufacturing and supply of crusher mill consumable steel wear parts and grinding media. Both operate within the broad foundry industry.

[6] The product overlap between the activities of the merging parties is found in the manufacture of four products which are: grinding media, high chrome mill liners, manganese rounds, and tumblers and idlers.

[7] There are no significant competition concerns in relation to the overlap products except for grinding media. With respect to high chrome mill liners, we are satisfied that there are imports which provide efficient delivery and supply better quality products than the merging parties, which will exert competitive constrain to the merging parties post merger. With respect to manganese rounds, and tumblers and idlers, despite the relatively low market shares, there are ample suppliers in South Africa which will act as a competitive constraint to the merged entity. We therefore only deal with grinding media in our analysis as it is the only overlap product which raises competition concerns in this transaction.

¹ Ozz Industries' sites include; Eclipse East, Eclipse West in Benoni, Boksburg Foundry in Boksburg and the Dimbaza foundry in the Eastern Cape.

² The Commission found in Scaw's documents that Ozz currently has excess capacity to produce high chrome grinding media, but cannot optimally use the capacity as it does not have the heat treatment technology, but the merging parties argue that Scaw will upgrade Ozz's Disa line to produce high chrome grinding media.

³ The merging parties provided details of synergies anticipated by Scaw; See Pgs. 187-196 of the merger record.

Grinding media

[8] Grinding media are spheres of alloy metallurgy which are used in ball mills/tube mills, cement plants, mines and thermal power stations. There are different grades of grinding media for different applications. Platinum and Gold Industries are the principle consumers of grinding media. Mining houses use both Scaw and Ozz's grinding media;- high chrome grinding media in the case of platinum mines, and standard grinding media for gold mines. The characteristic of grinding media depends on the method of production. High chrome grinding media are made by casting while standard grinding media are made from either forged steel or by casting. Scaw and Ozz Industries use different methods of producing grinding media, and produce grinding media which is different in shape and quality.

[9] According to the merging parties, Scaw utilizes the forged steel method for their grinding media and produces ball shaped grinding media. The process Scaw uses for its high chrome balls has been licensed from a Belgian company called *Magotteaux*. It was submitted that Scaw's process of producing high chrome balls is of *superior quality* with minimum wear rate without any risk of breakage.

[10] Ozz Industries produces truncated cone shaped grinding media (standard and high chrome) using the *chill casting method* which involves pouring molten metal into moulds made of cast iron, coated on the inside with graphite.⁴ It was submitted that the chill cast grinding media tends to be more porous making the casting prone to fracture and high wear rates.

GEOGRAPHIC MARKET

[11] The geographic market for the supply of standard and high chrome grinding media is considered to be national including some imports from China which, according to the merging parties, play an important role. Goldfields and Harmony uses Chinese grinding media (Standard) for approximately 90% of their requirements. Though no concerns were raised about the quality of Chinese imported grinding media, the Commission in its interview with Goldfields found that Chinese imports are more expensive due to exchange rate of the rand.

COMPETITION ANALYSIS

[12] The Commission argued that this merger is likely to lead to a removal of an effective competitor in the market for standard grinding media and the market for high chrome grinding

⁴ Ozz Industries' high chrome grinding media are produced without the heat treatment that Scaw uses.

media. In both the standard grinding media and high chrome grinding media, Scaw is the largest domestic supplier with approximately 90% market share in the high chrome grinding media and about 56% market share in the standard grinding media; while Ozz has a mere 1% market share in the high chrome grinding media, and 13% in the standard grinding media.⁵ Implied imports account for 6% in the high chrome grinding media, and 25% in the standard grinding media.⁶

[13] With respect to standard grinding media, the merging parties will have a combined market share of 69%. The merging parties point out that there is sufficient competition from Minmetals from China. However, according to the Commission, Minmetals products are substantially expensive to the local buyer, although large mining houses such as Goldfields and Harmony have procured from Minmetals because they have found that supply from Scaw is unreliable.

[14] The merging parties argued that notwithstanding Scaw's dominance in both markets, Scaw's prices are, and will continue to be constrained by the presence of imports from China, and the buying power of the mining companies, which have countervailing power. The essence of the merging parties' argument is that Ozz is not and has never been an effective competitor in the grinding media market⁷, and that Chinese imports serve as a competitive constraint to the merging parties.

[15] The Commission contended that what is important is not Ozz's insignificant market share, but, Ozz's ability to provide increasing competitive discipline to Scaw, especially in light of its recent introduction of Eclipsoid which it is believed will provide better alternatives to other products in this market. The Commission further argued that Ozz has excess capacity which Scaw lacks, and that Ozz's market share should be viewed in the context of all these factors.

Eclipsoid

[16] This is a product which is a modification of Ozz's Cylpeb, which was currently launched by Ozz in 2006. There is no intellectual property that attaches to the eclipsoid. According to the

⁵ See Table 3 and Table 5 on pgs. 25-26 of the Commission's recommendations, and Table 9 and Table 10 on pgs. 140-141 of File 1 of the merger record.

⁶ Minmetals has 19% and Chinese imports have 6%.

⁷ Given the differences between Scaw and Ozz Industries' products, particularly having regard to their quality differences; one is inclined to argue, on the face of it, that Ozz does not provide a good competing alternative to Scaw's products.

Commission, except for Impala Platinum which has tested eclipsoid and found that it has a better wear rate than the cylpeb, and relatively compete with Scaw's balls,⁸ no other mining houses have tested this product. The Commission based its assessment of the effectiveness of the eclipsoid on the test results from Impala, and contended that the eclipsoid renders Ozz an effective competitor to Scaw's steel balls, and that even though it is currently at its infancy, it will experience growing market acceptance, and various mining houses are yet to conduct tests on its effectiveness, which is likely to remove a potential effective competitor.

[17] According to Ozz Industries, they do not intend to expand their grinding media capacity as they intend to focus on production of wear parts and crushers. They also argued that it is impossible for Ozz to use the West Plant to produce eclipsoid as the facilities do not allow this given that there are no chill casting facilities at this plant, and it is currently impossible to produce the chill cast eclipsoids in this plant.

[18] Having regard to the aforementioned arguments by the Commission and the merging parties, we find it difficult to arrive at any significant conclusion on the eclipsoid. However, we find that there are other competition concerns in this merger which make it likely to substantially prevent or lessen competition in the grinding media market.

High Concentration in the grinding media market

[19] It is common cause that the grinding media market is highly concentrated, with an HHI increase of 476.84 in the high chrome grinding media, and change of 1456 in the standard grinding media market. Aside from Ozz, the other local producers are small and do not provide better alternative products.⁹

[20] This is a 2-to-1 merger, combining the only two larger local firms in the supply of grinding media domestically. Imports are neither cost effective nor the most viable alternative source of supply for all customers, especially the smaller customers which may consider the price of the product as an important consideration, and which will be impacted negatively should the merging parties decide to profitably increase prices to their customers.¹⁰

⁸ Eclipsoid is priced about 30% lower than the ball shaped grinding media produced by Scaw.

⁹ Minmetals is the only competitor which provides better alternative products.

¹⁰ We accept the Commission's argument that imports are not more competitive than the locally produced products due to high import prices and other import logistical constraints.

High barriers of entry

[21] Entry in the standard grinding media is considered to be difficult due to requirements of specific technical expertise in the market and intellectual property.¹¹

CONCLUSION

[22] Having regards to the concerns raised in the foregoing, we conclude that this merger is likely to substantially prevent or lessen competition in the grinding media market in South Africa.

[23] The merging parties advanced certain production efficiencies which failed to address all the concerns raised in this transaction, in particular, the pricing concerns which might impact negatively on customers post merger. However, the merging parties negotiated pricing remedies with the Commission in order to address the competition concerns in the affected market. The conditions were extensively canvassed by the Commission and the merging parties at the hearing. In the end, we are satisfied that these conditions alleviate the concerns raised, and accordingly approve this merger with the conditions attached.¹²

_____	<u>Date</u>
D Lewis	21 July 2008

N Manoim and Y Carrim **concurring**.

For the merging parties: Advocate J Wilson instructed by Webber Wentzel Bowens

For the Commission: D. Motsamai (Legal Services Division)

H Ratshisusu (Mergers & Acquisitions)

Researcher: L Xaba

¹¹ Except for Minmetals which entered through its parent company, China Minmetals Corporation, approximately 10 years ago, there has not been any other entrant of note in the recent past.

¹² See Annexure A of these reasons.