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## **Will cement merger stick?**

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**Competition analysis: What competition issues will be of concern to the European Commission in relation to the proposed merger between Lafarge and Holcim? Frances Murphy, a leading competition partner at Bingham McCutchen in London, assesses the transaction and the likelihood of merger clearance.**

### **Original news**

European cement companies in possible merger, LNB News 07/04/2014 14

*City AM, 7 April 2014: French cement company Lafarge are in talks with Swiss rival Holcim over a possible merger. The combined company would have sales of approximately \$40bn (£24bn) and an estimated market value of \$50bn.*

### **What is the background to the proposed merger and why are the parties contemplating such a significant (and potentially controversial) deal now?**

The transaction appears to result from the reduced profitability of the production of cement, aggregates and ready-mix concrete (RMX) and related products, which has been a feature of the market in the West over the last few years. RMX production tends to be a local business. The market is mature and over the recession RMX producers have experienced falling demand, over capacity and falling returns. In the light of the indications of a recovery, the merging parties may well be seeking to reposition themselves in order to best capitalise on new opportunities. In addition, the merging parties may be looking to extend their geographic reach to give them a wider global spread. Holcim has a strong presence in Asia and Latin America and this would complement Lafarge's in Africa. This kind of global spread could serve to reduce the merging parties' exposure to the risks of regional slowdowns.

In addition, after several years of stagnation, the construction sector is picking up which is increasing the demand for RMX and other building materials. At the same time, the cost of credit remains relatively low, which can be vital if, as here, suitable purchasers will need to be found for the assets the merging parties will be required to shed as a condition of the transaction being cleared by the European Commission (see below).

### **What are likely to be the main issues of concern and is a Phase II referral inevitable?**

The combination will make the merged entity the single largest RMX producer worldwide. The main issue appears to be the significant market power the combination would give Lafarge and Holcim in particular countries.

In terms of capacity, Lafarge and Holcim are two of the biggest manufacturers of RMX in the world. Their merger, even if they shed a substantial part of their assets to placate competition authorities, will create a

behemoth in the market for RMX and related products. It is anticipated that the merged entity would be able to negotiate better deals with its suppliers and demand higher prices from its customers.

Another issue is that the market for RMX is highly concentrated. Markets tend to be national and in the EU there tends to be only a few producers in each country. High barriers to entry and low margins make it difficult for new entrants to gain a foothold in the market. The more highly concentrated a market is, the greater the concern that price coordination and/or market sharing will occur. In this regard the regulators will be particularly concerned, the market for cement and related markets have a long history of manufacturers being found by the competition authorities to have been fixing prices and sharing markets.

To allay the anticipated concerns Lafarge and Holcim have pledged to sell assets equivalent to 10% to 15% of their combined earnings before interest, taxes, depreciation and amortisation to overcome regulatory hurdles. Two-thirds of these asset sales would happen in Western Europe and the US.

The European Commission is already reviewing two interlinked cement deals between Holcim and Cemex. The first relates primarily to German assets, and the second concerns a Spanish asset sale. European Commissioner, Almunia, has recently made it clear that he considers an in-depth Phase II investigation of this proposed merger between Lafarge and Holcim to be inevitable.

It remains to be seen whether the European Commission ultimately decides to conditionally clear the transaction or to block it altogether. Much will depend on the breadth and depth of the remedies Lafarge and Holcim are prepared to offer the European Commission and whether the extent of the remedies that may be required would remove the commercial rationale for the transaction.

### **What impact will recent and on-going investigations in this sector have on this merger?**

Due to the highly concentrated nature of the RMX sector and the propensity some of the market participant have demonstrated to coordinate their market behaviour, the market for RMX and related markets have been the subject of scrutiny by the European Commission and national competition authorities for many years. In December 2010, the European Commission launched an investigation into the market for cement. The investigation is ongoing and its impact on the transaction may be double-edged. On the one hand, the European Commission knows the market and the merging parties, which may result in a smoother merger review process. On the other hand, this knowledge may result in more substantial remedies being required to assuage competition issues.

As mentioned above, the European Commission is already reviewing two transactions between Holcim and Cemex, whereby Holcim is acquiring part of Cemex's business in western Germany, Belgium, the Netherlands and France (see Holcim/Cemex West), and is selling to Cemex its own operations in Spain (see Cemex/Holcim assets). Applying the priority principle, the European Commission will deem these transactions as complete when reviewing the Lafarge/Holcim transaction. This should help the merging parties obtain a clearance with regard to Spain. However, in Western Germany, Belgium, the Netherlands and France the transaction will prompt the European Commission to require more substantial remedies from the merging parties.

### **Will crafting suitable remedies be problematic in such a concentrated market (eg finding 'suitable purchasers' which won't themselves create their own concerns)?**

This appears to be the case. The European Commission will no doubt require the merging parties to divest a substantial part of their businesses across the EU. In this regard, the European Commission is likely to follow in the footsteps of the Competition Markets Authority in the UK (formerly the UK Competition Commission), which has recently concluded its market investigation into the markets for cement, aggregates and RMX (see Aggregates, cement and ready-mix concrete market). In order to restore competition in these markets, two leading manufacturers were required to divest two of their plants to a third party who is not currently active in the market in Great Britain. In addition, a number of behavioural remedies were imposed, including restrictions on the publication of market data.

The European Commission may further require that the divested assets be sold to a single purchaser that could effectively compete with the existing market players. In the recent case of UPS/TNT Express, the European Commission required the merging parties not only to find a single buyer of all the divested assets up front, but also to enter into a binding contract with it prior to the conclusion of the investigation in a Phase II investigation. The main reason for such a material remedy was the highly concentrated structure of the market. As the markets for cement and related products display similar characteristics, it is very likely that the European Commission will require an up-front buyer solution again. This would make the position of the parties extremely difficult.

See further EU merger remedies policy and practice.

### **What potential efficiencies might the parties rely upon in defence of the merger?**

The transaction should result in a number of efficiencies. First, it may be that the merging parties could be able to reduce their operational costs by eliminating all unnecessary duplication of work and capacity. Any such savings could be passed on to customers through lower prices. The merged entity may also be intending to invest any such savings in research and development, which could also be to the ultimate benefit of customers.

Both Lafarge and Holcim are quintessentially European companies with their headquarters located in Europe, they derive a significant proportion of their revenues in the EU. However, the European Commission has shown on several recent occasions (eg Deutsche Börse/NYSE Euronext) that it does not always take such considerations into account when deciding on whether to clear or block a merger.

See further Efficiencies and customer benefits in merger control.

### **What kind of time period might we expect in terms of pre-notification discussions with the Commission and other relevant regulatory authorities?**

The pre-notification discussions will very likely be lengthy.

It is in the interest of the merging parties to cover as many issues as possible during the pre-notification discussions with the European Commission to expedite the review process once the clock for merger clearance has started post filing of the application to the European Commission for merger clearance. The merging parties can attempt to offer a substantial package of remedies upfront in order to try to convince the European Commission to ultimately clear the transaction. In the light of the highly concentrated nature of the market, and the extent of the information, the European Commission will require to explore the breadth and depth of the asset disposals that will be required in order for there to be effective competition and the extent to which appropriate purchasers can be found for those assets, it would not be surprising if the pre-notification discussions were to take several months.

In China, pre-notification discussions can take as long as it takes for the Ministry of Commerce People's Republic of China (MOFCOM) to consider the notification complete. In practice, this can be anything between one and five months.

*Interviewed by Yacine von Welczeck.*

*The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.*