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PROPOSED ACQUISITION BY FIRST STRONGHOLD CEMENT INDUSTRIES, INC. OF SHARES IN HOLCIM PHILIPPINES, INC.
M-2019-018

Executive Summary of the Statement of Concerns dated 02 December 2019
Issued by the Mergers and Acquisitions Office

31 January 2020

Abstract of the Transaction

The Transaction involves the purchase by First Stronghold Cement Industries, Inc. ("**First Stronghold**") of a total of 5,531,566,062 common shares equivalent to 85.73% of the total issued and outstanding capital stock of Holcim Philippines, Inc. ("**Holcim**").

First Stronghold, the acquiring entity, is a wholly-owned subsidiary of San Miguel Equity Investments, Inc. ("**SMEII**"), which in turn is a wholly-owned subsidiary of San Miguel Corporation ("**SMC**"). The ultimate parent entity of First Stronghold, SMEII, and SMC is Top Frontier Investment Holdings, Inc. ("**Top Frontier**"). On the other hand, Holcim, the acquired company, is mainly engaged in the manufacture, sale, and distribution of cement and cementitious products and aggregates, and the provision of technical support on various construction-related quality control, optimization, solutions development, and skills upgrade. The Transaction will allow SMEII, through First Stronghold, to venture into, and explore capital investment opportunities in, the cement market.

Notification of the Transaction

The Parties' respective Notification Forms were filed on 06 June 2019 and the Phase I review of the Transaction commenced on 09 July 2019.

Phase I Review of the Transaction

The initial market investigation conducted by the Mergers and Acquisitions Office ("**MAO**") under a Phase I Review indicated that the Transaction may negatively affect the cement industry particularly the market for the supply of grey cement in Northern Luzon, further subdivided into Northwest and Northeast Luzon, the rest of Luzon, Visayas and Northern Mindanao, Southern Mindanao, in terms of higher prices, fewer choices, lower output, and quality.

In order to assess whether the proposed transaction will substantially lessen competition in the identified markets and the likelihood that competitors in such markets will coordinate their behavior or strengthen existing coordination in a manner that harms competition, the MAO decided to continue the investigation under a Phase II Review.

Phase II Review of the Transaction

The MAO on 22 August 2019, informed Top Frontier and Holcim that it will proceed to a Phase II Review of the transaction.

In the course of the Phase II Review, the MAO concluded that post-Transaction, there is no loss of competition in the sale of grey cement in South Luzon, Visayas, and North Mindanao, and Southern Mindanao.

However, with respect to the geographic markets of:

i. **Northwest Luzon**, which is composed of the provinces of La Union, Benguet, and Pangasinan; and

ii. Central Luzon, Northeast Luzon, and Greater Metro Manila. Central Luzon, for purposes of MAO's analysis, is composed of the provinces of Aurora, Bataan, Nueva Ecija, Pampanga, Tarlac, and Zambales. Northeast Luzon is composed of the provinces of Cagayan, Isabela, Nueva Vizcaya, and Quirino. Finally, Greater Metro Manila is composed of the provinces of Bulacan, Metro Manila, Rizal, and Cavite. Central Luzon, Northeast Luzon, and Greater Metro Manila shall collectively be referred to as **"CL + NEL + GMM"**.

The MAO finds that the proposed Transaction will likely result in substantial lessening of competition in the relevant markets, for the following reasons:

1.1. In the market for grey cement in Northwest Luzon, the proposed transaction eliminates each party's only competitor in that market, creating a **merger-to-monopoly** situation; and the proposed transaction will increase Top Frontier's market power and enable it to increase prices, reduce output, and/or decrease quality of its products.

1.2. Similarly, in the geographic market of CL + NEL + GMM, the transaction would eliminate an entity which is an important source of competitive constraint, thereby enhancing Top Frontier's market power allowing it to increase prices, reduce output, and/or decrease quality of its products.

Top Frontier and Holcim's Cement Businesses

As of date, Top Frontier has incorporated a number of entities that are contemplated to engage in the cement business, all of which are currently non-operational. Of note are two (2) upcoming cement plants that are slated to begin commercial operations within the next two years: San Miguel Northern Cement, Inc. ("**SMNCI**"), a 70-30 joint venture with Northern Cement Corporation ("**NCC**"), and Oro Cemento Industries Corporation, which is located in Davao. Top Frontier likewise has a 35% stake in NCC.

Holcim is a publicly-listed corporation and a subsidiary of LafargeHolcim Ltd. ("**LH**"). It currently operates eight (8) cement facilities in the Philippines, four (4) of which are integrated plants. The remainder comprises grinding facilities and bulk terminals. LH is active in four business segments: cement, aggregates, ready-mix concrete, and solutions and products. However, Holcim disclosed to the MAO that it is in the process of winding down its ready-mix concrete business in the Philippines.

Inclusion of Certain Entities in the Top Frontier Notifying Group

The MAO considers, for purposes of its review, NCC and Eagle Cement Corporation ("**Eagle**") as part of the Top Frontier Notifying Group. This conclusion was arrived at through the MAO's examination of relevant documents and information received from the Parties and publicly-available information, as well as feedback received from stakeholders in the course of its market investigation.

To recall, Top Frontier has a 35% shareholding in NCC, which is not disputed. However, the MAO determines that, the minority stake notwithstanding, Top Frontier exercises control over NCC such that the former has the ability to materially influence policy relevant to the behavior of the latter in the marketplace. In arriving at this assessment, the MAO considered the following factors:

- Based on its market investigation, the MAO finds that Top Frontier has the ability to control corporate matters affecting the operations and strategic incentives of NCC;
- Top Frontier's *de facto* ability to appoint [xx] out of the seven (7) directors of NCC allows it to control the actions of the Board of Directors;
- The pattern of voting in both stockholders' and Board of Directors meetings show alignment of interests or decision-making between Lucky Star Holdings, Inc. ("**Lucky Star**") and Top Frontier;
- The close personal relationship between Mr. Eduardo Cojuangco, Jr. ("**Mr. Cojuangco**") of Lucky Star and Mr. Ramon S. Ang ("**Mr. Ang**") of Top Frontier indicates that the incentives of both shareholders of NCC are more aligned than would otherwise be the case;
- Despite its minority shareholding, Top Frontier had access to sensitive corporate information of NCC by reason of its directorates, among others; and
- The MAO's market investigation revealed that market participants view NCC as forming part of the Top Frontier Notifying Group.

On the other hand, with respect to Eagle, the MAO determined that it forms part of the Notifying Group by considering first, the link between NCC and Eagle, and second, the connection between Top Frontier, Mr. Ang, and Eagle. The MAO's conclusion in this respect is hinged on two findings:

- From its examination of ordinary course documents provided by the Parties, the MAO has sufficient reason to believe that NCC and Eagle are under common control; and
- Mr. Ang's occupancy of key positions in Top Frontier (President, director) and Eagle (President, controlling stockholder) indicate that he owes fiduciary duties to both.

> Therefore, insofar as the cement industry is concerned, it is difficult to conceive that he can serve the interests of Top Frontier at the expense of Eagle, of which he owns a majority of the shares.

In view of the foregoing, the MAO included NCC and Eagle in Top Frontier's Notifying Group for purposes of its market definition and assessment of competitive effects arising from the Transaction.

<u>Unilateral Effects</u>

The MAO's market investigation revealed that the merger is likely to harm competition significantly by creating or enhancing market power unilaterally through the elimination of an important competitor in the relevant market for the sale of grey cement. The MAO finds that the Transaction will result in **(i) a merger to monopoly in Northwest Luzon** and **(ii) a merger of close competitors in undifferentiated product markets in CL + NEL + GMM.**

Northwest Luzon

In Northwest Luzon, the MAO determines that the acquisition will result in the acquiring entity consolidating high market shares in three measures of market shares (volumes, actual capacity, and future capacity). In terms of volumes sold, the combined market shares of the parties are at [90-100] percent. It is likewise no different in terms of plant capacity—the combined market shares will be at [90-100] percent. Even taking into account future prospective capacities, Top Frontier's post-Transaction market share will still be at [90-100] percent. These three measures of market shares show that Top Frontier will be able to monopolize the market for grey cement in Northwest Luzon.

The Transaction combines virtually the only two viable rivals in the market. The merging parties operate the only two cement manufacturing plants in the area. The merger will therefore eliminate Top Frontier's only competitor as the only other manufacturing plant and the only other viable source of grey cement supply in the Northwest Luzon market. No other domestic supplier nor importer can viably supply this area because of high transportation costs and other barriers to entry and expansion.

The MAO through extensive field investigations also received strong objections to the merger from dealers of cement who are generally concerned that Top Frontier will acquire its only competitor.

Compared with the pre-Transaction scenario where Northwest Luzon has two (2) large firms, both of which behave strategically such that each makes decisions by taking into account the other competitor's choices, the proposed Transaction will eliminate competition from Holcim and is expected to create market power for Top Frontier. As such, the MAO submits that it is a clear case of **merger-to-monopoly** that is likely to bring about a substantial lessening of competition.

CL + NEL + GMM

In CL + NEL + GMM, the MAO's market investigation reveals that the Transaction will likewise result in a substantial lessening of competition for the sale of grey cement. Using the same three measurements of market shares above, the Transaction will result to a combined market share at [60-70] percent in terms of volumes sold, [50-60] percent in terms of actual capacities, and [50-60] percent in terms of future capacities. The high combined shares in a quantity-setting market will allow Top Frontier post-Transaction to control a majority of the supply and capacity in this area.

The MAO also determines that the Transaction also eliminates a competitor with a significant source of competitive constraint because Holcim and Top Frontier compete with each other closely in the CL + NEL + GMM market. The acquiring party will remove a very important competitor in the market and the firms present will decrease from five to four. With the consolidation of the capacities in the hands of one firm, it will be inevitable that prices increase by reducing output from current levels.

Likewise as in the Northwest Luzon market, many customers expressed grave concerns about the merged entity gaining control over prices and supply in the market.

Thus, the MAO posits that post-Transaction, Top Frontier will acquire control over more than half of total market share in terms of volume and capacity. Comparing the counterfactual that the two parties will continue to operate separately and compete, the Transaction will eliminate an important competitive constraint that exists between the two merging firms, and lead to a **merger of close competitors in undifferentiated product markets** that is likely to bring about a substantial lessening of competition**.**

<u>Coordinated Effects</u>

In evaluating coordinated effects, where a merger may increase the likelihood that firms engage in coordination or strengthen existing conditions for coordination that may stifle competition in the relevant markets, MAO takes a look at whether market conditions and industry traits are conducive to coordinated behavior, and whether coordination is facilitated after the transaction.

The MAO's market investigation confirms that the cement industry is vulnerable to cartel behavior. Market conditions in the cement industry facilitate an environment where it may sustain anti-competitive agreements. Considering that the Transaction will reduce the number of competitors in the identified geographic markets, it will further aggravate these pre-existing market conditions, among others to wit:

a. ***Few active competitors*.** With less active players in the market as a result of the Transaction, it is easier to come to a mutual understanding. Less market players will mean that monitoring compliance and deviation will only become easier in the identified markets due to the elimination of a competitor from the merger.
b. ***Repeated Interaction between cement manufacturer and its customers*.** The repeated interaction promotes market transparency, allowing easier coordination and monitoring of deviations from the coordinated outcome.
c. ***Low demand elasticity.*** Market investigation has shown that the nature of cement and its intended use makes it a commodity with a high price-inelastic demand. As demand

elasticity of cement is low, there is increased incentives of manufacturers to coordinate due to the low trade-off between high prices and lost sales.

d. ***High degree of product homogeneity*.** The high degree of product homogeneity of grey cement simplifies many dimensions of competition in the market, increasing the ability of firms to reach a coordinated outcome.
e. ***High barriers to entry and expansion.*** High capital costs and the time it will take to set up a cement plant, as well as the difficulty to import in the CL + NEL + GMM region, lead to a conclusion that there are high barriers to entry which limit external competitive constraints that may discipline coordinated action.
f. ***Market transparency*.** Dimensions in which firms compete such as capacities, output levels, and prices are sufficiently transparent in the market of CL + NEL + GMM, which can facilitate collusive behavior in a market that will become more concentrated post-Transaction. MAO notes that post-Transaction, Top Frontier, shall automatically become a member of CeMAP by virtue of its shareholding in Holcim. This *de facto* membership of the acquiring entity of the trade association will significantly increase information transparency between the remaining firms, facilitating coordination or maintenance of coordination between firms.
g. ***Stable market with limited innovation.*** The low innovation characteristic of the cement market makes it is easier to sustain and monitor deviations from the coordinated outcome.

The Transaction will reduce the number of players in the CL + NEL + GMM market necessary for a successful coordination to take place or strengthen existing coordination. Instead of four (4) significant players, there will only be three (3) players post-Transaction. As there is a significant degree of transparency as to price and capacity levels of the players in the relevant markets, which parties take advantage of by actively monitoring how their competitors behave in the market, deviations from the coordinated outcome can be easily detected which facilitates or strengthens coordination between the firms active in CL + NEL + GMM. Further, the low elasticity of demand and presence of excess capacity enables coordinating firms to discipline each other.

The MAO finds therefore that the Transaction increases the likelihood of coordination or will strengthen existing coordination between firms in CL + NEL + GMM, leading to a substantial restriction of competition in the CL + NEL + GMM market.

<u>Barriers to Entry</u>

In the course of its market investigation, the MAO concludes that neither entry nor expansion will be timely, likely or sufficient to counteract the competitive concerns raised by the Transaction in the Northwest Luzon and CL + NEL + GMM markets.

The MAO observes that there is no *de novo* entry that is likely or timely to counteract the market power that will be gained by Top Frontier from the Proposed Transaction. Within the Northwest Luzon market, no players have indicated plans to enter the market, while Top Frontier has confirmed expansion plans through SMNCI.

While there are expansion and entry plans by two (2) firms in CL + NEL + GMM, the MAO believes these would not serve to constrain any price increase or decrease in output to be implemented by the merged firm post-transaction. In fact, these cannot even rival Eagle's *pre-expansion* capacity. The gap between capacities will only become more glaring as a result of the proposed transaction.

The MAO notes that some domestic producers consider imports as an emerging competitive threat, and despite the small inroads imported cement has made in certain parts of the country since 2016, the evidence indicates that imported cement is of little competitive significance in the Northwest Luzon and CL + NEL + GMM markets today.

The MAO believes this is unlikely to change considering that the availability of imports is limited by regulatory barriers. On 4 September 2019, the Department of Trade and Industry (DTI) imposed a definitive safeguard duty on imported cement. This follows the DTI's imposition of a provisional safeguard duty for a period of 200 days since February 2019, during which the Tariff Commission conducted a probe into the cement industry. These safeguard duties are an additional barrier to importation, elevates costs during the three-year duration of the policy and creates a disincentive to import that further dilutes any competitive pressure imported cement may exert in Philippine markets, notwithstanding other area-specific issues in local markets.

In addition, port infrastructure constraints and congestion prevents imports from imposing sufficient constraint on the merged entity post-Transaction.

<u>Proposed Voluntary Commitments</u>

Top Frontier, during the course of the Phase II Review, proposed voluntary commitments to address the competition concerns of the MAO. Upon review of Top Frontier's proposed voluntary commitments, the MAO finds that the proposal does not clearly and sufficiently address the elimination of competition in the identified relevant markets resulting from the transaction.

A sufficient remedy should prevent the expected negative impact on competition or at least reduce the anti-competitive effects to a degree that eliminates the ground for a prohibition as required under the PCA. If a market is characterized by effective competition without the transaction, the remedy has to ensure that the transaction will not result in a situation in which competition is reduced.

However, the MAO determined that the commitments put forward by Top Frontier did not address the lasting change to market structure that results from the Transaction. Consequently, MAO was constrained to reject the proposed commitments.

Conclusion

Therefore, the MAO concludes that the Transaction will likely result in a substantial lessening of competition in the market for grey cement in **Northwest Luzon** and **CL + NEL + GMM** because of the following reasons:

- In Northwest Luzon, the Transaction is a **merger-to-monopoly** and will eliminate the only competitor of Top Frontier in the relevant market.

- For both Northwest Luzon and CL + NEL + GMM, the **Transaction will create market power for Top frontier** and will allow it to unilaterally increase prices, reduce output, and deteriorate quality.

- The Transaction will **facilitate coordination** between firms in CL + NEL + GMM, restricting competition in the said market.

- **Imports** in the relevant markets **are not sufficient to constrain** Top Frontier, post-Transaction, **from exercising market power** leading to a substantial lessening of competition.

- **Barriers to entry are high** and there is **no possibility of a new entrant, from imports or domestic manufacturers,** that can constrain Top Frontier from exercising market power post-Transaction in the relevant markets.

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