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NEWSALERT

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ULTRATECH: CEMENTING ITS WAY TO THE TOP

1. INTRODUCTION

On August 21, 2018, the Competition Commission of India (the "**Commission**") approved the acquisition of Century Textiles and Industries Limited ("**Century**") by UltraTech Cement Limited ("**UltraTech**"). Through this combination, UltraTech has proposed to acquire the cement assets of Century, situated in the Indian states of Madhya Pradesh, Maharashtra, Chhattisgarh and West Bengal.

Notably, this is the fifth acquisition for which UltraTech has had to take the Commission's approval. In fact, as recently as a few months ago, the Commission approved UltraTech's proposed acquisition of 100% of the equity shares of Binani Cement Limited.[1]

We highlight below the key aspects of the approval by the Commission.

2. KEY ASPECTS ADDRESSED BY THE COMMISSION

2.1 Delineation of the relevant geographic market

To delineate the relevant geographic market in this sector, the Commission has recognised that cement, being a bulk commodity, involves significant transportation costs, has a low shelf life and cannot be easily transported over long distances. Accordingly, the consumption of cement is generally centered around the production clusters and therefore, the relevant geographic market in the cement sector is usually delineated by giving due consideration to the state in which the overlapping production clusters are located. Having said that, the determination of the *exact* relevant geographic market in a combination in the cement industry is imperative because any inclusion of an additional state or area in the relevant geographic market may widen the relevant market, without reflecting effective competitive constraints. In this regard, the Commission has relied on the *Elzinga Hogarty Test* (the "**EH Test**") and on *catchment area analysis* to determine the exact scope of the relevant geographies which may potentially be affected by the combination.

These two tests have been discussed in detail in the following section.

[1] Combination Registration No. C-2018/02/558- UltraTech/Binani Cement Limited, order dated March 27th, 2018

2.2 Tests to determine the relevant geographic market

(a) Catchment area analysis

A *catchment area* is the geographical area from which a particular location draws its customer or prospects. A catchment area with respect to a combination in the cement sector is generally identified as the geo-oriented location up till which a product can flow.

Accordingly, catchment area analysis, in relation to the present case, is based on the feasibility of the distance for the shipment of cement. After considering efficiencies and transportation costs, feasibility for cement plants to dispatch their output to different states is also considered to determine the relevant geographic market. The geographic market may further be extended beyond the catchment area as the demand and supply conditions may result in the shipment of cement from anywhere in India. This is, however, subject to economic viability and other constraints such as shelf life of the cement, transportation costs etc.

(b) The EH Test

The EH Test assesses whether significant product flows are present between two areas relevant for the competition assessment. With respect to a proposed combination, the EH test is used to analyse patterns of product origin and destination by evaluating the volume of production dispatched ("**Outflow**") from and received ("**Inflow**") in a particular area.

If the Outflow or Inflow of products is found to be insignificant, based on a certain threshold, it is concluded that firms in one area do not face competition from firms in other areas. In particular, the EH test sets criteria for imports to a region and exports from a region, based on two thresholds: *little in from outside* ("**LIFO**"); and *little out from inside* ("**LOFI**").

The LIFO criterion states that a certain minimum percentage of the product sold in an identified region must be produced within that region, and the LOFI criterion states that a certain minimum percentage of shipments originating from an identified region must be to a location within that region.[2] However, these percentages are not fixed, and the Commission can use its own discretion to set the thresholds, depending on the sector to which a combination relates.

It may be relevant to note that, for the purposes of delineation of the relevant geographic market using the EH Test, the Commission has relied on the inter-state cement dispatch data for the year 2011-12, to determine the production and consumption percentages in the present case.

2.3 Use of installed capacity to determine the market share

The Commission has also taken into consideration *installed capacity* to determine market share of the parties to the combination operating in the cement sector, instead of taking into consideration *volume* or *value of sales*. One possible reason for this is the unavailability of the dispatch data after the year 2011-12. Given

[2] W.E Schrank and Noel Roy, Econometric Modelling of the World Trade in Groundfish, NATO ASI Series, Springer

how unstructured the data in the cement sector is, the Commission possibly felt the need to rely on factors other than value and volume of sales figures for the year 2011-12, especially since relying on figures as old as those, to determine the market share of players in a combination proposed to take place in 2018, would not have made sense.

3. INDUSLAW VIEW

Although the catchment area analysis is less scientific than the EH Test, being based on fewer variables, the Commission was right to place reliance on this test in addition to the EH Test in order to delineate the relevant geographic market in the present case. This is primarily because the dispatch data used for the determination under the EH Test dates back to 2011-12 and is not likely to take into account efficiencies and developments in infrastructure, transportation and technology that may have taken place since. The catchment area analysis is, therefore, likely to bridge any anomaly in the application of the EH Test alone.

Upon completion of the proposed acquisition, UltraTech is likely to acquire a substantial market share in the identified relevant geographic markets of Madhya Pradesh, Maharashtra, Chhattisgarh and West Bengal, with a *post combination concentration ratio* of the four largest firms in those geographies, which is approximately 61% in Madhya Pradesh, 46% in Maharashtra and 68%, collectively, in Chhattisgarh and West Bengal. While its market share in these relevant markets has incrementally increased only by 3%, 4% and 6%, respectively, the approval of this combination will, undoubtedly, further strengthened UltraTech's position in the cement industry. However, the Commission does not anticipate the likelihood of any substantial adverse effect on competition, as the change in the *Herfindahl–Hirschman Index* prior to and after the combination is less than 250.[3]

It is worth bearing in mind that the Commission rigorously scrutinised the combination of Lafarge S.A. with Holcim Ltd. in 2015 and ultimately approved it with certain modifications. The existence of LafargeHolcim in the cement industry is, undoubtedly, an important factor in enabling the inorganic growth of UltraTech without any significant merger control risks.

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[3] Combination Registration No. C-2015/07/288, PVR/DLF Utilities Limited, order dated May 4th, 2016