



Public Competition Assessment

6 August 2015

CSR Limited and Boral Limited – proposed clay bricks joint venture

Purpose

1. This public competition assessment outlines reasons for the Australian Competition and Consumer Commission (**ACCC**) decision on 18 December 2014 to not oppose CSR Limited and Boral Limited's proposed clay bricks joint venture (the **proposed joint venture**).
2. A Public Competition Assessment is a detailed summary of the ACCC's reasons and issues considered by the ACCC in a merger review and is generally published when:
 - A merger is opposed
 - A merger is subject to enforceable undertakings
 - The merger parties seek such disclosure
 - A merger is cleared but raises important issues that the ACCC considers should be made public
3. By publishing a Public Competition Assessment, the ACCC aims to provide guidance to the public about the ACCC's analysis of the competition issues involved in certain merger reviews.
4. The ACCC considers each public competition assessment on a case-by-case basis. While some transactions may involve the same or related markets, the analysis and decision outlined in one assessment will not necessarily reflect the ACCC's view about other transactions.
5. The ACCC considers confidential information from merger parties and other market participants when making a decision. Our assessments may not identify and explain all issues that we considered because we must maintain confidentiality about certain information and sources.

The proposed joint venture

6. The proposed joint venture involved CSR and Boral combining their clay brick businesses located on the east coast of Australia including their operations in New South Wales/ACT, Victoria, Queensland, South Australia and Tasmania. Boral's

clay brick operations in Western Australia do not form part of the proposed joint venture. The joint venture entity will be 60% owned by CSR and 40% owned by Boral.

7. The proposed joint venture comprised the manufacture, marketing and supply of clay bricks, as well as associated clay sourcing activities. Under the proposed joint venture, CSR and Boral will no longer offer separate clay brick product ranges or compete on price or other terms of supply to customers in eastern Australia.
8. The joint venture parties also each supply building products such as plasterboard, insulation solutions and roof tiles, however these other building products are not part of the proposed joint venture.

The ACCC's decision

9. On 18 December 2014, the ACCC announced its decision not to oppose the proposed joint venture. The ACCC decided that the proposed joint venture would be unlikely to have the effect of substantially lessening competition in contravention of section 50 of the *Competition and Consumer Act 2010* (the **Act**) in state markets for the supply of clay bricks.
10. The ACCC considered that, in comparison to the status quo, the proposed joint venture would raise significant competition concerns. However, based on detailed information provided by Boral and other parties, the ACCC was satisfied that it was likely that Boral and the key assets would leave the relevant markets if the proposed joint venture did not proceed.
11. The ACCC did not consider a future with the proposed joint venture to be substantially less competitive than a scenario in which Boral would close its brick plants and exit the relevant markets. In either scenario, the ACCC considered it likely that the three major brick suppliers in the relevant markets would be reduced to two.
12. Further details regarding the ACCC's reasoning are provided below.

The parties

CSR Limited

13. CSR supplies various building products including plasterboard, fibre cement, insulation, processed glass, autoclaved aerated concrete (under the Hebel brand name) and roof tiles.
14. CSR supplies clay bricks under the PGH brand and manufactures clay bricks at Horsley Park, Schofields and Cecil Park in NSW, Oxley in Queensland, and Golden Grove in South Australia. CSR also has 'mothballed' part of the clay brick manufacturing capacity at Cecil Park in Sydney and all the capacity at Bathurst in western NSW.

Boral Limited

15. Boral supplies building products and construction materials including plasterboard, fibre cement, insulation, concrete products, timber products and roof tiles.

16. On the east coast, Boral supplies clay bricks under the Boral Bricks brand and manufactures clay bricks at Bringelly and Albury in NSW, Darra in Queensland, Thomastown and Scoresby in Victoria. Boral also has mothballed all the clay brick manufacturing capacity at Badgerys Creek in NSW.

Other industry participants

Austral Bricks

17. Austral Bricks is a subsidiary of Brickworks Limited. Relevantly, Austral Bricks supplies clay bricks which it manufactures at Horsley Park, Punchbowl and Bowral in NSW, Rochedale in Queensland, Wollert in Victoria, and Golden Grove in South Australia. At the time of the ACCC's review of the proposed joint venture, Austral Bricks also had mothballed part of its clay brick manufacturing capacity at Horsley Park in NSW, Rochedale in Queensland, and Golden Grove in South Australia.¹

Other brick suppliers

18. There are a number of smaller brick suppliers active on the east coast. However, these are generally considered 'niche' players, with small capacities, a limited or speciality brick range and/or are not widely distributed. The largest is Selkirk, based in regional Victoria. However, all others supply negligible quantities in comparison to the three major brick suppliers. The ACCC's market consultation identified that smaller brick suppliers do not currently exercise significant competitive constraints on major suppliers, nor would they be likely to in the future.

Industry background

19. Clay bricks are generally classified as:

- face bricks – which are typically used on the exterior of a building and are manufactured in different colours and with different textures for aesthetic appeal, and
- common bricks – or 'commons', which are typically used where they will not be seen, particularly in foundations or for rendered facades, since they do not have a particular aesthetic appeal or surface treatment.

20. The clay brick production process commences with the mining and collection of clay. This clay is then mixed with water and dried before firing. Bricks are required to be 'fired' in kilns for between 10 to 40 hours depending on the kiln, type of brick to be produced and its appearance. Face bricks and common bricks are produced using very similar manufacturing processes, with minor variations to achieve different aesthetic qualities in relation to face bricks.

21. Clay brick supply is principally directed at low-rise residential construction, whereas commercial construction principally uses other materials, as does high-rise residential construction. The ACCC's review was therefore focussed on the likely competition effects of the proposed joint venture in relation to low and medium-density residential construction.

¹ The ACCC understands that Austral Bricks has recently recommissioned mothballed capacity at its Horsley Park and Golden Grove plants.

Review timeline

22. The following table outlines the timeline of key events in this matter.

Date	Event
9 April 2014	ACCC commenced review under the Merger Review Process Guidelines.
29 April 2014	ACCC requested further information from the joint venture parties.
1 May 2014	Closing date for submissions for interested parties.
16 May 2014	ACCC requested further information from the joint venture parties. Former proposed decision date of 26 June 2014 delayed to accommodate provision of requested information from the joint venture parties.
26 May 2014	ACCC received the joint venture parties' response to its information request of 29 April 2014.
2 June 2014	Review suspended at the request of the joint venture parties. The joint venture parties requested more time to provide additional information to the ACCC (including information requested by the ACCC on 16 May 2014).
12 September 2014	ACCC received additional information from the joint venture parties.
16 October 2014	ACCC published a Statement of Issues outlining preliminary competition concerns.
6 November 2014	Closing date for submissions relating to Statement of Issues.
18 December 2014	ACCC announced it would not oppose the proposed joint venture.

Market inquiries

23. The ACCC received written submissions from and/or spoke with a very large number of interested parties including builders, relevant industry associations, brick suppliers, and suppliers of other forms of external cladding.

Statement of Issues

24. The ACCC published a Statement of Issues (**SOI**) in relation to this transaction on 16 October 2014.

25. In the SOI, the ACCC stated its preliminary view that the proposed joint venture would be likely to substantially lessen competition in the NSW and Queensland clay bricks markets compared to a future where the three major suppliers continued to operate independently.

26. The ACCC also expressed the preliminary view that the proposed joint venture *may* substantially lessen competition for the supply of clay bricks in Victoria and South Australia. CSR does not manufacture bricks in Victoria and Boral does not manufacture bricks in South Australia, however the activities of the two businesses still overlapped, with CSR and Boral relying on interstate supply to service Victoria and South Australia, respectively.
27. In the SOI, the ACCC sought further information from market participants in relation to the likely future without the proposed joint venture. Market responses to this issue, along with extensive material provided by the joint venture parties, informed the ACCC's final decision as discussed further below.

Market definition

28. The relevant markets were considered to be the markets for supply of clay bricks in each of NSW (including ACT), Queensland, Victoria, South Australia and Tasmania.
29. In reaching its conclusion, the ACCC assessed a range of other external cladding products to determine whether they were in the same market as clay bricks. These products included:
- autoclaved aerated concrete (AAC), the main brand of which is Hebel
 - fibre cement
 - concrete wall panels
 - concrete masonry, and
 - structural insulated panel systems.
30. The ACCC recognised that the use of these other external cladding materials has increased, while the use of clay bricks has decreased, in the past 20 years. This has in part been due to the trend towards construction of multi-residential dwellings, for which clay bricks are less commonly utilised.
31. The ACCC also recognised that the use of these other external cladding materials may increase in the future, largely due to an ongoing shortage of bricklayers and consequently increased costs to secure bricklaying labour. However, this potential shift in demand away from bricks is associated with factors that are external to clay brick suppliers, rather than being due to the pricing behaviour or other competitive dynamics between suppliers of external cladding products.
32. The ACCC concluded that other external cladding products are not currently close substitutes for clay brick, or likely to be in the foreseeable future. The ACCC's market inquiries generally identified that residential demand for clay brick is derived from the preferences of end-use customers who prefer clay brick for its aesthetic appeal as well as perceived functional qualities such as low maintenance and durability.
33. Therefore, an attempted 5-10% price increase in clay bricks is unlikely to be defeated by the availability of other external cladding materials. While other external cladding materials are often used in combination with clay bricks to add aesthetic appeal to the façade and other exteriors of a home, in these cases,

alternative external materials are complements to, rather than substitutes for, clay brick.

34. The ACCC considered the likely competition effects of the proposed joint venture on the basis of markets for supply of clay bricks, which encompass both face and common bricks. The ACCC analysed the ability for customers to switch between face and common bricks, and for brick manufacturing plants to viably switch between face and common brick production. However, the ACCC did not find it necessary to form a concluded view as to whether face and common bricks may be more appropriately considered separate markets as it did not materially affect the ACCC's competition assessment.
35. The ACCC defined state-based markets for the manufacture and supply of clay bricks. This was based on the results of the ACCC's inquiries which identified that the major clay brick suppliers contract with customers on a state basis, clay brick prices vary somewhat depending on the state, and price increases are implemented on a state-by-state basis. Also, transport costs for clay bricks can be high relative to the total value of the product meaning that most clay brick demand is supplied by plants located in the same state as that customer demand arises (although, as noted above, the major clay brick suppliers do supply some clay bricks interstate).

Likely future with and without the proposed joint venture

36. Section 50 of the Act prohibits mergers or acquisitions that would have the effect, or be likely to have the effect of substantially lessening competition in a market. In assessing a proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment post-acquisition if the acquisition proceeds (the "with" position) to the likely future competitive environment if the acquisition does not proceed (the "without" position) to assist in determining whether the proposed acquisition is likely to substantially lessen competition in any relevant market.
37. In the case of some mergers under review by the ACCC, it is claimed that the target business is failing and will exit the market absent the proposed acquisition. As noted in the ACCC's Merger Guidelines, to demonstrate that a merger will not substantially lessen competition due to the prospective failure of one of the merger parties, it is generally necessary to show that:
 - the relevant firm is in imminent danger of failure and is unlikely to be restructured without the merger
 - in the absence of the merger, the assets will leave the industry, and
 - the likely state of competition with the merger would not be substantially less than the likely state of competition after the target has exited and the target's customers have moved their business to alternative sources of supply.
38. These considerations may also be relevant when the ACCC is assessing a claim that a specific business (but not the remainder of the company or corporate group) is failing and likely to exit the relevant market absent the proposed acquisition. The ACCC carefully examines and verifies such claims. This can include examinations of senior executives from the target firm as well as third parties, examination of accounts and other financial information, review of board papers

and other documents, with particular weight being given to those created before the proposed acquisition was contemplated.

CSR and Boral's clay brick businesses

39. In its review of CSR and Boral's proposed joint venture, the ACCC considered whether, in the absence of the proposed joint venture, Boral and CSR would remain competitors or whether Boral and/or CSR as well the key assets would exit brick supply in one or more of the relevant markets. In considering this issue, the ACCC conducted market inquiries and took into account publicly available information. In addition, extensive confidential information provided by CSR and Boral and other interested parties was considered.
40. The ACCC also took into consideration:
- the evidence of a senior Boral executive as to the likelihood of exit and why there were no suitable alternative options to the proposed joint venture,
 - the historical and forecast financial performance of Boral's brick business, and
 - information evidencing the long-term structural decline in demand for clay bricks and historic performance of the clay brick manufacturing industry as a whole.
41. The ACCC formed the view that, in the absence of the proposed joint venture, CSR would not be likely to exit the supply of clay bricks in any relevant market. However, the ACCC concluded that Boral would be likely to exit the supply of clay bricks in the relevant markets and realise the land value of its manufacturing plants.
42. The ACCC then assessed whether, without the proposed joint venture, another party would be likely to acquire Boral's brick business and continue to use Boral's brick manufacturing assets, thus providing an independent competitive constraint in the markets in comparison to the future with the proposed joint venture.
43. The ACCC conducted inquiries with market participants, and took into account the low rates of return achieved by brick suppliers, the long term structural decline of the brick manufacturing industry, and the impracticality of physically moving a brick kiln to a new site.
44. In particular, the ACCC had regard to a range of detailed information about Boral's financial position, including a comparison of the underlying value of Boral's clay brick sites in NSW and Victoria and the value of the ongoing brick operations in those states. This was a critical component of the ACCC's assessment and involved a detailed review of internal Boral documents and independent valuation reports that had been prepared for Boral management by qualified valuers.
45. Based on all of this information, the ACCC concluded that it was unlikely that any other party would be interested in purchasing Boral's brick manufacturing sites in NSW, Victoria and Queensland (for use in brick manufacturing rather than an alternative use) at a price equal to or higher than their underlying land value. Accordingly, the ACCC concluded that, in the absence of the proposed acquisition, it was likely that Boral's clay brick manufacturing assets in these

states would effectively leave the relevant markets as Boral sold the clay brick sites to realise the significant underlying land value.

Conclusion - likely future without the proposed joint venture

46. As set out above, the ACCC concluded that, without the proposed joint venture, it was likely that Boral would exit the supply of clay bricks in eastern Australia and realise the land value of its manufacturing sites in NSW, Victoria and Queensland.
47. This conclusion was critical to the ACCC's assessment of the proposed joint venture. Having reached this conclusion, the ACCC considered whether the likely future with the proposed joint venture would be likely to be substantially less competitive when compared with the likely future without the proposed joint venture (in which Boral and its clay brick manufacturing assets would be likely to exit the relevant markets).

Competition analysis

48. The ACCC considered that, consistent with the preliminary view it expressed in the SOI, the proposed joint venture raised significant competition concerns if Boral (or an alternative owner/s of Boral's assets) was likely to have continued supplying clay bricks absent the proposed joint venture.
49. In comparison to the status quo, the proposed joint venture would effectively create a duopoly of major brick suppliers in New South Wales and Queensland. This would be likely to materially reduce the intensity of competition between the remaining two major clay brick suppliers, and/or result in a general reduction in competitive tension.
50. The proposed joint venture would also be likely to alter the nature of interdependence between rivals, such that the joint venture entity and Austral Bricks would be more likely to independently reach the conclusion that it would be in their interests to tacitly coordinate their key commercial decisions, such as price increases and/or production capacities. This coordination would not require any explicit communication or commitment between the rivals. Rather, they would each act in their own self-interest, taking into account each other's likely actions and reactions.
51. The ACCC did not identify any smaller actual or potential clay brick suppliers which would have the ability and/or incentive to competitively constrain the actions of the joint venture entity and/or Austral Bricks. In particular, the ACCC considered that the small brick suppliers generally operate in niche segments of the relevant markets, and/or operate on a very small scale which is incapable of having any material impact on the major brick suppliers.
52. Due to significant barriers to entry and expansion, and the structural decline of the industry, the ACCC did not consider it likely there would be new entry or expansion on a scale that would be competitive with the major suppliers in the relevant markets.
53. Despite this, having formed the view that it was likely that Boral would leave the relevant markets and that its clay brick manufacturing assets would leave the industry if the proposed joint venture did not proceed, the ACCC did not consider the future state of competition with the proposed joint venture to be substantially

less than the state of competition in a scenario in which Boral closed its bricks plants in NSW, Queensland and Victoria and left the relevant markets. With or without the proposed joint venture, the ACCC considered it likely that the three major brick suppliers in the relevant markets would be reduced to two.

Conclusion

54. After a detailed assessment, the ACCC concluded that Boral was likely to exit from the relevant markets and that its clay brick manufacturing assets would leave the industry if the proposed joint venture did not proceed. Based on this conclusion, the ACCC formed the view that CSR and Boral's proposed clay brick joint venture would not be likely to have the effect of substantially lessening competition in any of the relevant markets in contravention of section 50 of the Act. The ACCC therefore decided to not oppose the proposed joint venture.