

The counterfactual

Introduction

1. This Appendix considers the counterfactual to the merger of Corus's UK sheet piling commercial operations with Arcelor. In particular it summarizes our understanding of the positions of Corus, Arcelor and Salzgitter prior to the merger, and then looks at a number of different scenarios that could potentially have arisen if the merger had not proceeded. These scenarios are divided between two categories: those in which Corus would have continued to supply HRSSP (or sheet piling) in the UK and those where it would have ceased to do so. Under each scenario we consider the evidence we have received as to the likelihood of such an outcome.
2. We start by summarizing the positions of Corus, Arcelor and Salzgitter as they were immediately prior to the deal between Arcelor and Corus on 27 April 2004.

The position of Corus

3. Corus had a maximum capacity to roll 380,000 tonnes of HRSSP a year on its Scunthorpe Heavy Section Mill (HSM). Its total shipments in 2003 were [REDACTED] tonnes. Corus told us that it lacked an HRSSP product that would be competitive in mainland Europe (wide Z shaped and to a lesser extent wide U shaped sheet piling) and that the HSM was uneconomic by comparison with mills owned by its competitors and other Corus mills, in particular the Teesside Beam Mill (TBM) and the Scunthorpe Medium Section Mill. Nonetheless, Corus retained a strong (but declining) position in the UK market for narrower HRSSP (with a market share in 2003 of between 65 and 75 ([REDACTED]) per cent). This was built on customer loyalty, service and technical support. Corus believed that narrow U shaped sheet piling would continue to be suitable in around 60 per cent of applications in the UK. In any event the change to the more efficient wide Z shaped sheet piling would be gradual because of the need for users to acquire expensive new piling equipment to drive it into the ground.
4. Corus provided us with management information which showed that its HRSSP business had made a small [REDACTED] loss of £[REDACTED] million in the year ended 31 December 2003. Corus told us that although its UK business achieved comparatively good margins, the UK market was too small to cover the fixed costs of operating the HSM. As a result Corus was exporting two-thirds of its sheet piling production to Europe and the rest of the world, where it fetched much lower prices and margins. Although these sales made a small contribution to the fixed costs of the HSM, in 2003 this was insufficient to make the business profitable overall; furthermore Corus's financial analysis showed that the financial performance of export sales of HRSSP [REDACTED].
5. Corus's financial plan (as updated in April 2004) indicated that the HRSSP business would make [REDACTED] Corus had reduced the operation of the HSM from 15 shifts to ten shifts in January 2004.
6. Corus told us that over a number of years it had attempted to address the situation of its HRSSP business by developing new products, by investing in its capability to produce wider sheet piling, or by forming an alliance with another [REDACTED] manufacturer [REDACTED]. However, Corus concluded that the only significant new product it developed (cold formed wide Z shaped sheet piling) was not competitive; the investment needed

to produce wider HRSSP was prohibitively expensive (and it would have been irrational to invest in sheet piling production when there was considerable excess capacity in Europe); and all the proposals for an alliance had foundered, [REDACTED].

The position of Arcelor

7. Arcelor told us that it had invested heavily in its Belval mill and in two other mills to enable it to roll wide Z shaped sheet piling and transfer production of beams elsewhere. By the end of 2003 this had increased the capacity of the Belval mill to between 400,000 and 500,000 ([REDACTED]) of sheet piling per annum. On the strength of this, Arcelor had started selling to the UK via a stockholder and had recruited an ex-Corus employee with knowledge of the contracting industry to initiate a sales drive into the UK. Through a pricing policy designed to achieve market entry it had managed to achieve between 5 and 15 per cent ([REDACTED] per cent) market share in 2003.
8. At the same time Arcelor had identified a further investment of €[REDACTED] million, which would eliminate bottlenecks in the finishing department and take the capacity of the Belval mill up to over 600,000 tonnes ([REDACTED] tonnes) a year. Arcelor's actual sales in 2003 were over 400,000 ([REDACTED] tonnes).
9. The management consultants appointed jointly by Arcelor and Corus in November 2003 to assess the benefits of joint ventures between the two companies reported that the combined sheet piling capacity of Corus, Arcelor and Salzgitter was [REDACTED] tonnes (and potentially [REDACTED] tonnes more after further investment by Arcelor), which exceeded European demand in 2003 by [REDACTED] tonnes (nearly half or [REDACTED] per cent). Indeed, following the further investment, Arcelor's one mill would have sufficient capacity to supply the whole of European demand. Arcelor was aware that Corus's total sales of HRSSP in Europe (EU 25 plus Norway and Switzerland) in 2002 were substantial (around [REDACTED] tonnes). The management consultants had also identified synergy benefits from a possible joint venture between Arcelor and Corus, [REDACTED], of between €[REDACTED] million (£[REDACTED] million) and €[REDACTED] million (£[REDACTED] million).

The position of Salzgitter

10. Salzgitter told us that it had acquired the Hoesch Spundwand & Profil (HSP) Union Mill in Dortmund, Germany from Thyssen Krupp in 2000. It proceeded to invest heavily in the mill so that it could produce wide Z shaped and U shaped sheet piling. By the end of 2003 the capacity of the mill was over 300,000 ([REDACTED]) tonnes a year, compared to sales in 2003 of over 200,000 ([REDACTED]) tonnes. Salzgitter also told us that its sheet piling business had [REDACTED]. Its UK market share before the merger was between 10 and 20 per cent (around [REDACTED] per cent).
11. Salzgitter had established a marketing joint venture for sheet piling with Thyssen Krupp, to maximize its sales and marketing effort worldwide. In the UK the joint venture had sold sheet piling through a stockholder. Although Salzgitter had approached two members of Corus's sales and marketing team, it had decided not to employ them. Salzgitter told us that its priority was to increase its margins in the UK before increasing its sales. [REDACTED]
12. Salzgitter was purchasing feedstock (slabs of semi-finished steel) for its Dortmund mill from third parties (mainly from Huta Katowice in Poland). Salzgitter told us that [REDACTED]. Although this problem had subsequently eased, the market price of slabs has risen significantly. As a result, Salzgitter had concentrated on producing those

products with the highest margin. Many of its other products had higher margins than sales of UK sheet piling.

13. According to press reports Salzgitter has started up a new blast furnace in November 2004 and it intends to reline an existing operational blast furnace in August 2005. Accordingly by 2006, at the latest, Salzgitter should be able to reduce its purchases of slabs by around 500,000 tonnes a year, although this will not eliminate the need for purchases of slabs altogether.

Possible counterfactuals

14. In the following section we consider different scenarios which might have come about had the merger of Corus's UK sheet piling commercial operations with Arcelor not taken place on 27 April 2004. These fall under two headings dealing respectively with those scenarios where Corus remains as a supplier of HRSSP and those where it ceases to be a supplier.

Corus remains as a supplier of hot rolled steel sheet piling

15. We identified four possible scenarios for consideration under this heading:
 - A1 Corus continues operating the Scunthorpe HSM.
 - A2 Corus invests in the HSM so that it can produce wide Z shaped sheet piling.
 - A3 Corus operates the HSM while it invests in the TBM, prior to switching production to the TBM and closing the HSM.
 - A4 Corus retains its sheet piling sales force and sells imported hot rolled steel sheet piling, having closed the HSM.

A1 Corus continues operating the Scunthorpe HSM

16. This scenario is similar to four other scenarios (namely A2, A3, B3 and B4—see paragraphs 15 and 35). The distinction between this scenario and the others is that in this scenario Corus is assumed to continue with its sheet piling business indefinitely in an entirely passive way—ie without taking any active steps to improve its position.
17. Our assessment is that, if the merger had not proceeded, Corus would have closed the HSM by the end of 2005. [REDACTED] The following paragraphs summarize the evidence in Corus board papers and other strategy documents, which support this view.
18. In October 2002, following an internal strategy review, several proposals to restructure Corus's section mills, forming part of Corus's UK Restructuring programme, were presented to the Executive Committee of the board of Corus. The presentation concluded as follows:
 - Existing piling range is uncompetitive and will come under increasing pressure following new Eurocodes.
 - Over £[REDACTED] million capital expenditure is required to expand product range, but mill is still remote from mainland European market.

- Mill is profitable through peak of the cycle [X].
 - [X]
 - [X]
19. A memorandum by the chief executive of Corus for a meeting in February 2003 dealt with the same two issues:
- Heavy sections production. [X]
 - Potential alliances. [X]
20. In April 2003 the managing director of Corus Construction & Industrial long products business wrote a memorandum for the board of Corus. It identified possible regulatory problems in a joint venture with Arcelor in HRSSP, [X]
21. [X]
22. [X] the plan was clearly flexible. We tried to assess whether Corus's sheet piling business might have become more profitable leading it to reconsider its stance on any closure decision.
23. As noted above, the management information that Corus has submitted to us indicates that the HRSSP business had made [X] and had made an [X] loss in 2003 [X]
24. We considered whether the increase in steel prices that has occurred after the merger might have increased the profitability of Corus's sheet piling business so that Corus would have changed its mind about closing the HSM. Corus told us that the very high selling prices for slabs (semi-finished steel) that have arisen would actually have encouraged it to close the HSM early.
25. Nonetheless, if the price of sheet piling had risen relative to other steel products, sheet piling might have become relatively more profitable and therefore more attractive to Corus. Corus told us that, on the contrary, the price of slab and plate¹ had risen more in percentage and absolute terms than the price of HRSSP had, in the recent period of steel price increases, so HRSSP would not have become more attractive to it. Even if the price of HRSSP had risen more than those other products, it would anyway be impossible to tell whether this would still have happened if Corus had remained as a producer of sheet piling.

A2 Corus invests in the HSM so that it can produce wide Z shaped piling

26. Corus told us of a succession of initiatives aimed at developing a new and competitive sheet piling product. Shortly before the merger it had been attempting to produce wide Z shaped sheet piling with ball and socket interlocks on the HSM. Although it is conceivable that some breakthrough might have been achieved, the major problem seems to have been the width of the mill stands. Corus would then have had to assess the likely return it would achieve on the investment needed, possibly including several new mill stands.²

¹Slab being the principal feedstock of HRSSP and plate being an alternative finished product made from slab.

²As Salzgitter had found necessary at Dortmund.

27. In July 2003 Corus evaluated an option to produce wide Z shaped sheet piling on the HSM and concluded that it would only increase its profitability [X] by £[X] million a year. Since the amount of investment required was estimated to be £[X] million this was not attractive. Corus told us that the investments by Arcelor and Salzgitter had undermined the rationale behind any new investment in sheet piling since EU capacity now greatly exceeded demand. Indeed it considered that in any case Arcelor would probably have a better, lower cost product. It seems that Corus would ideally need to find a superior product that it could produce with relatively little investment, and preferably at a lower cost than Arcelor.

A3 Corus operates the HSM while it invests in the TBM, prior to switching production to the TBM and closing the HSM

28. Corus also evaluated this option in July 2003 and concluded that it would increase profitability by £[X] million a year [X]. The amount of investment required was put at £[X] million, which according to Corus's calculations would have given a payback period of 12 years and an IRR (internal rate of return) of [X] per cent.
29. Corus told us there would have been several drawbacks with this option. During the period of switch-over from the HSM to the TBM (roughly two years) the HSM would be under loaded; the residual production capacity for sections at the TBM would be too low to enable Corus to retain a credible competitive position in Europe and Corus would no longer be able to produce the full range of sections after some beam production had been displaced from the TBM.
30. Corus added that this level of investment return was well below its hurdle rate for approving non-essential capital expenditure (ie excluding essential replacement expenditure and that needed to meet environmental or health and safety legislation), which would normally require a payback period of [X] years and an IRR of [X] per cent. In addition, having incurred considerable losses since it was formed in 1999, Corus operated with cash constraints. Finally, the project assumed a [X] per cent increase in sales. This sales growth was considered to be at risk when there was excess capacity and both Arcelor and Salzgitter would also be looking to maximize sales.

A4 Corus retains its sheet piling sales force and sells imported hot rolled steel sheet piling, having closed the HSM

31. [X]
32. We asked Corus whether it had ever seriously considered setting up a trading operation as a way of extracting value from its profitable UK sheet piling business in the event of a cessation of production. It told us that such an approach was considered but quickly discounted by the Commercial Director. This was because it could only be a short-term option as either supplier (Arbed or Salzgitter) would have been expected to move quickly to sell directly and thus avoid having to pay any commission on its sales to the UK. Customers would also have been expected to switch to direct supply in order to save money.
33. Corus also concluded that exit from sheet piling production should not weaken other parts of its sections business, as the customer base was different. Additionally there was no incentive to trade semi-finished steel for sheet piling, as the UK restructuring programme had already identified alternative uses for the production of semi-finished steel at Scunthorpe (through increasing production of plate and rod at Scunthorpe

and taking over the supply of steel to mills previously supplied from Teesside, which was to have a new role selling slabs on the open market).

34. Arcelor told us that it had never discussed such an arrangement with Corus and that it would not have been interested in this, even if it had been discussed. As a producer of sheet piling it was in Arcelor's interests to have direct access to the final customer and to retain the entire margin for itself. Corus would have been treated like any other stockist. [✂]

Corus ceases supplying HRSSP

35. We identified four possible scenarios for consideration under this heading:
- B1 Corus sells its UK sheet piling commercial operations to Salzgitter and closes the HSM;
 - B2 Corus sells its UK sheet piling commercial operations to another party (eg Mittal Steel) and closes the HSM;
 - B3 Corus closes the HSM before the end of 2004; and
 - B4 Corus closes the HSM by the end of 2005.

B1 Corus sells its UK sheet piling commercial operations to Salzgitter and closes the HSM

36. Corus's stated desire for a strategic alliance to derive some value from the closure of the HSM suggests to us that it should have been willing to offer the business to Salzgitter, if the merger with Arcelor had fallen through. However, at no stage during the negotiations with Arcelor was the business offered to Salzgitter, and in its written submissions to the CC Corus appears to have ruled out the possibility that it ever would have been. Corus submitted that while negotiations with Arcelor were progressing well there was no need to cast the net wider and, given the sensitivity of closure, the risk of a leak if an auction process was initiated was unacceptable.
37. Nonetheless, if negotiations with Arcelor had collapsed, we consider such an approach would have been a logical one if Corus intended to cease production of sheet piling, not least because the option of closure of the HSM on its own would imply no value creation and entail higher closure costs (eg redundancy payments to the sales team). Furthermore, [✂] the possibility of selling the commercial interests in sheet piling to either Salzgitter or Arbed (now part of Arcelor) if the joint venture did not proceed had been mentioned in the past. Corus submitted, however, that reaching an agreement with Salzgitter was unlikely given the previous history of discussions.
38. Salzgitter told us that its desire was not to increase sales in the UK so much as to increase its margins. [✂] In our view the acquisition of the Corus sales team should have been attractive to Salzgitter, depending on the price it would have had to pay. Salzgitter has told us that it would not have tried to buy additional access to the UK market, because of the market share it already had and because of the risk of losing 'bought' market share to competitors.
39. Salzgitter also told us that it had to buy feedstock (semi-finished steel slabs) on the world market in order to supply its Dortmund mill. [✂] For this reason we consider

that the timing of any approach by Corus in April 2004 might not have been ideal from Salzgitter's point of view. However, it is reported that Salzgitter has started up a new blast furnace from November 2004, ultimately increasing steel capacity by 500,000 tonnes a year, so in our view a delay in any deal between Corus and Salzgitter might have been needed while it increased its capacity first. Alternatively, we believe it is possible that Corus could have supplied Salzgitter with slabs from Teesside (assuming it had not been sold).

B2 Corus sells its UK sheet piling commercial operations to another party (eg Mittal Steel) and closes the HSM

40. We have not received any evidence that Corus had considered selling its business to any other party or that anyone else would have been interested. Nonetheless, a deal with Mittal Steel might have had some logic as the group was already producing sheet piling in Poland (at ISPAT Polska Stal, formerly Huta Katowice), appears to have an excess supply of semi-finished steel and intends to invest further.

B3 Corus closes the HSM before the end of 2004

41. [X]
42. Corus told us that if the HSM had been closed in these circumstances, the sales force would either have been made redundant or redeployed within Corus. Certainly in the former case they would have been available to be recruited by either Arcelor or Salzgitter.

B4 Corus closes the HSM by the end of 2005

43. [X]