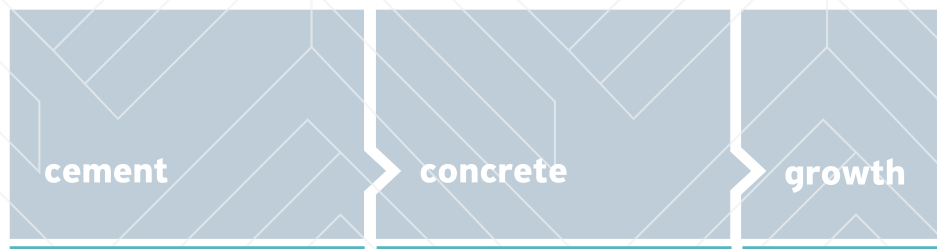


Introduction – The “Value Bar”

The “Value Bar” – an explanation!



The “Value Bar” – the economics



Vertical Integration is a “winner” if:
Increases the “Value Bar” in normal conditions or keeps it intact in bad times

Observations

Vertical Integration allows
you to cut the “Value Bar” any way you choose.

Cutting the “Value Bar”
in different ways does not increase it.

How does Vertical Integration add value to the cement chain? ...would Vertical Integration?

Enable cement prices to be increased whilst maintaining ready-mix margins?

In effect enable the increase of concrete price.
Or cut costs.

Enable cement prices to be increased to third party customers?

In effect influence the supply-demand balance for cement.

Enable cost reduction between the two operations?

In effect enable identification and realisation of synergies.

OFFENSIVE

Enable the maintenance of cement volumes in downturn?

Enable full capacity utilisation at cement plant.

Enable ready-mix prices to be kept at high levels, particularly in downturn?

Enable a more orderly behaviour among the concrete producers.

DEFENSIVE

Test Conditions for adding value through Vertical Integration

OFFENSIVE

Enable cement prices to be increased whilst maintaining ready-mix margins?

In effect enable the increase of concrete prices or cut costs

- Can we prove the link between VI and increase in cement prices (i.e. not driven by supply-demand balance)?
- Can it be that there are significant costs that can be taken out of the ready-mix business?

Enable cement prices to be increased to third party customers?

In effect influence the supply-demand balance for cement

- Can we prove the link between VI and increase in cement prices (i.e. not driven by supply-demand balance)?
- If indeed this can be achieved, what will happen to imports? Is there a balance point?

Enable cost reduction between the two operations?

In effect enable identification and realisation of synergies

- Do we understand the synergies (if any) between the two businesses?
- Can these synergies be realised under common ownership?

DEFENSIVE

Enable the maintenance of cement volumes in downturn?

Enable full capacity utilisation at cement plant

- Is it really possible to increase cement market share in a downturn?
- Has this been done before? Under what circumstances?
- Can it be directly attributed to VI?
- Are there any effects on the economics of the downstream business?

Enable ready-mix prices to be kept at high levels, particularly in downturn?

Enable a more orderly behaviour among the concrete producers

- Is this behaviour attributable to Vertical Integration?
- Can ready-mix capacity be permanently decommissioned?
- How sustainable is such behaviour?
- How do we raise barriers to entry?

Can Vertical Integration subtract value from the cement chain?

In our experience we have seen:

- Low cement prices into concrete – resentful cement business, forced to give similar prices to other big concrete producers.
- High cement prices into concrete – resentful concrete business, loss of market share.
- Treat businesses as if they are operationally the same! Margins will not be the same and the infrastructure and CAPEX needed in the businesses will not be the same.
- Although margins will be different, there is no reason why ROI must also be different. Expect the same economic value from the businesses.
- Selection of people for the businesses can go wrong.

YES
Vertical Integration
can subtract value
from the cement
chain!

Is Vertical Integration offensive or defensive?

- Always arises during the discussion
- Arguments exist for both an offensive and a defensive intent behind Vertical Integration.

Does it matter whether VI is offensive or defensive? Perhaps, there are other considerations that drive VI?

It is quite legitimate to want to participate in a bigger part of your industrial chain but....

Avoid value destroying pitfalls

- Understand the different characteristics of the businesses
- Understand the interaction between the upstream and downstream
- Treat the businesses differently in operational terms
- Treat the businesses similarly in economic terms

Can Vertical Integration be unwound?

There are no examples of major disentanglement between cement and ready-mix concrete businesses.

There is no reason why cement and ready-mix concrete cannot be disengaged.

Why is this the case? Reasons can be:

- > Disengagement costs
- > Downstream businesses are value creating in their own right
- > Emotional considerations
- > Strong Vertical Integration conditions apply

Conclusions

There are certain conditions under which Vertical Integration makes sense

The link between VI and proposed benefits must be closely examined and proved

Putting together cement and downstream products can be value destructive

Lack of evidence in separating cement from downstream

It is not obvious that there is a universal answer to the VI question

The VI success conditions must be assessed from time to time and from market to market