

ANGLO AMERICAN/LAFARGE MERGER INQUIRY

Summary of hearing with Breedon Aggregates held on 10 October 2011

Background

1. Breedon Aggregates (Breedon) was formed in September 2010 out of the prepack administration of Ennstone plc. It produced and supplied aggregates, ready-mixed concrete (RMX) and asphalt, and also supplied a small amount of agricultural lime. It had recently acquired a small Lincolnshire business called C&G Concrete, which had two or three quarries and about 12 RMX plants.
2. Breedon was a member of the Minerals Products Association and the British Aggregates Association (which tended to focus on the smaller independents).
3. Breedon's annual turnover and profitability had declined for all companies as a result of the recession and it did not think the market was going to recover strongly, if at all. There had been a decline in volume of up to 30 to 40 per cent across all the products Breedon produced. It hoped for modest growth (of around 4 to 5 per cent) in revenue over the next few years, some of which would be acquisition led, such as its purchase of C&G Concrete, as opportunities for organic growth would remain fairly limited.
4. Aside from the recession, hydrocarbon and energy price increases over the last 12 months (as a result of significant increases in the price of oil) had had a huge impact on Breedon's business. Because energy costs had risen higher than expected, it was quite difficult to set prices that recovered these costs, and for the past year Breedon's pricing had been trying to keep pace with rising energy costs.
5. With respect to any regulatory impacts on its business, Breedon mentioned a carbon levy costing £0.6 million. Further, Breedon had to comply with and invest in a range of health and safety and environmental (noise and dust, etc) requirements. There was also an aggregates tax and a landfill tax, both of which had recently increased, encouraging recycling and making recycled materials more competitive.

Market definition and competition

6. Breedon supplied all market segments for aggregates, except aggregates with a polished stone value (PSV—a measure of skid resistance) over 60, which was a high-specification aggregate (often specified by the Highways Agency for road construction) and rail ballast. Although it was cheaper to move aggregates further distances by rail than truck, Breedon's quarries were not rail-connected.
7. Breedon agreed that while there was some substitutability between primary and secondary aggregates and recycled aggregates, it depended on the application. There was more substitutability for lower-specification applications. For example, secondary and recycled aggregates could not be used in place of high-PSV stone, but could be used for sub-base and fill applications. Supplies of recycled and secondary aggregates were also limited and tended to be in specific locations where the secondary aggregate was being produced or where there was a demolition site. There were not enough recycled aggregates to substitute fully for primary aggregates, which could be quarried as volumes required.

8. Because of technical specification requirements, it was not possible to use recycled aggregates to any meaningful or significant extent in RMX. However, Breedon did use recycled asphalt planings (or reclaimed asphalt planings (RAP)) in its asphalt mix and RMX. It was possible to recycle 5 to 10 per cent of total product output, if the asphalt planings were available and if specifications allowed.
9. Breedon purchased both GGBS and CEM 2 products using PFA but did not blend materials itself.
10. Breedon purchased GGBS from Hanson and PFA from Lafarge. There were not many alternative sources of GGBS. Breedon originally purchased GGBS from Paragon (Aggregate Industries), which imported it from Germany, but it had since switched supply to Hanson, which was cheaper as it obtained its supply domestically.
11. Breedon did not use volumetric trucks. Although difficult to operate, volumetric trucks had certain cost advantages, which independents had managed to exploit through their ability to offer small loads of different products. They were not, however, suitable for supply to large projects. Breedon said that, as an alternative to sourcing RMX concrete from fixed plants, on-site plants had always had their place. On-site plants significantly reduced haulage costs, but the costs of erecting an on-site plant could be up to £100,000, so they only made sense when volumes were large enough to cover that fixed cost. On-site plants started to become viable for volumes of around 30,000 cubic metres and upwards, particularly for volumes of 100,000 cubic metres. Breedon did not provide customers with an on-site plant as it had never been asked to supply one, but it did not believe it would have difficulty in sourcing one if asked. However, it noted that on-site plants had greater issues with reliability, and companies like Breedon positioned themselves as back-ups for those using on-site plants.
12. Breedon said that the viability of mobile asphalt plants, as alternatives to delivered asphalt, also depended on the size of the job. At around £1–£2 million, mobile asphalt plants represented a greater investment than an on-site RMX plant and a job would require at least 50,000 tonnes of asphalt and need to run for two or three years to make the investment worthwhile. Breedon did not have any mobile asphalt plants, although it was currently looking at the possibility of purchasing one in Scotland.
13. 15 to 20 per cent of Breedon's asphalt plants had planning consent to operate 24/7, and even for those plants without such consent it was sometimes possible to get temporary permission from the local planning authority to allow night-time production for a period of a month or so. There was an advantage in being able to produce at night, although there could be limits on truck movements and noise. The costs of production at night were higher in terms of manpower arrangements and maintenance, which therefore meant that prices were higher for work carried out at night. In terms of the planning process, the level of difficulty in obtaining 24/7 permission on a permanent basis depended on the location of the quarry and the potential for noise and disruption, etc.
14. If the costs of producing asphalt, aggregates or RMX rose by 5 or 10 per cent, Breedon would try to pass those costs on to the customer. It was constantly looking at ways of keeping its cost base as low as possible, which included exploring alternative materials.
15. A characteristic of the industry was that the materials or products did not travel very far before transport costs made supplying them uneconomic. The distance over which aggregates, asphalt and RMX could be transported economically was as follows: 30 miles for aggregates (although it could be further in rural markets, for

example up to something like 50 miles in Scotland, where there was less congestion and the population density was sparser), 30 miles for asphalt and about 10 to 12 miles for RMX. Therefore, its major competitors were located in the areas where it operated (central England and north of the Edinburgh/Glasgow corridor) and it was not possible to generalize on which companies competed with Breedon (for example, it might be Tarmac in the West Midlands and Lafarge in the East Midlands). It was necessary to look quite specifically at each market to understand what the competitor dynamics in that market were and who had significant market share.

16. Although Lafarge and Tarmac were key suppliers to Breedon, they also competed with Breedon on aggregates, RMX or asphalt, depending on the location. Although this was slightly unusual in terms of the industry, it was logical, as it related to distance of travel. For example, Lafarge might have an RMX plant or a concrete block plant in a location where their nearest source of aggregates was 40 miles away, while Breedon might have a sand and gravel operation only 5 miles away. In that situation, Breedon might be able to supply Lafarge with aggregates far more economically than Lafarge could supply itself. The same may be true in reverse in another location.

Breedon as a customer

17. Breedon did not have any swap agreements with Tarmac or Lafarge, but rather purchased on a case-by-case basis. It did not have a central procurement department and purchases were made at the local level by operational staff.
18. The limits in distance over which aggregates could be transported necessitated purchasing aggregates from multiple suppliers, as purchasing from the nearest supplier to the job enabled Breedon to get supply at the lowest cost.
19. There were two main reasons why Breedon did not produce its own cement: it did not have the right type of chalk or limestone deposits (which had to be significant) and building a cement plant was expensive (around £180 million). For the levels of cement Breedon used, it would not be economic for it to build a cement plant.
20. The cement Breedon acquired from Lafarge, Cemex and Hanson was not purchased under contract and Breedon could change supplier when it wished. It regularly monitored the market to ensure that it was getting a good price and considered the price it was paying for cement competitive. It had never been refused a quote from a supplier. Most cement suppliers increased their prices in January (Breedon had already received a letter from Cemex notifying it of a price increase in January 2012) and increases were driven by inflation and also specific issues like the carbon tax (cement production involved a lot of carbon dioxide emissions). Breedon felt that it was able to negotiate on prices.
21. Breedon had not purchased imported cement because it was not price competitive, although it considered that imported cement helped keep the price of UK cement down. When an importer began importing cement, it was not uncommon for one of the major companies to purchase the import terminal through which the cement was being imported and Breedon thought that the major companies owned a large number of the import terminals in the UK. There was a lot of surplus cement capacity in the Republic of Ireland, Greece, Turkey and Egypt that could be imported into the UK at attractive prices.
22. Breedon was not sure whether there was any excess capacity of cement in the UK. The UK had a mixture of very new facilities, such as Buxton and Rugby, and very old facilities that had very high carbon costs, so it was possible that the major cement

manufacturers might prefer to import cement than source it from those older production facilities. Breedon said that cement plants had closed in the UK (Cemex recently closed Barrington, while Lafarge closed Westbury and Northfleet).

23. The price differential between imported cement and UK-produced cement was fairly small. However, Breedon would not switch away from Lafarge in Scotland to imported cement unless there was some reasonable economic benefit. Breedon was concerned about the reliability of supply of imported cement. It did not want to switch to imported cement only to find a delayed shipment forced it to go back to its original supplier. Consistency of quality was another concern with imported cement. (Although the quality of cement from the Republic of Ireland and Egypt was perfectly adequate, there was still a lot of additional testing that had to be done to be sure.) Importers would need to quote at least 5 to 10 per cent lower than UK cement in order for Breedon to switch.

Purchasing process

24. Customers could purchase Breedon's cement in three ways: on a contractual basis (eg for 12 months' supply), a job-by-job basis (ie for the term of a particular job) and on a spot basis. The pricing was determined almost on a week-to-week basis and was driven by a wide range of factors, depending on: the availability of material in the quarries, what the customer wanted, the customer's location and the location of the quarry and the cost of haulage. There was also a degree of negotiation with the customer on price, although customers did not always tell Breedon about quotes from other companies, preferring instead to state what price they wanted. Breedon tried to differentiate itself from the major competitors by providing a much higher level of service, including evening and weekend delivery and a higher level of personal interface with the customer.

Barriers to entry/expansion

25. The main barriers to entry in the production of aggregates or cement were: the high capital cost of the plant, the relatively low price of products (along with the current severe downturn in demand), finding a suitable reserve and obtaining the necessary planning consents. Acquiring mineral reserves was a speculative process and even when a site was found, obtaining new planning consent was very difficult (there had not been any new hard rock quarries planned in the last ten years and the last totally new site was probably 30 years ago). Because of the difficulties in getting planning consent for new quarries, including environmental impact considerations, operators sought extensions to existing operations instead. It was easier to get permission for an extension to an existing quarry than it was to get permission for a brand new quarry, although in both circumstances it was only possible if the request fell within the level forecast demand set by the local planning office. A supplier would not open a quarry specifically to service a customer, with the exception of starting a small 'borrow pit' along the line of a road.

The counterfactual

26. Were the joint venture not to occur, Breedon considered that Anglo American would attempt to sell the Tarmac assets to someone else, as it had been trying to sell the business for a number of years. Lafarge, on the other hand, might incur large capital costs in having to update its cement mills, but other than that, Breedon did not see Lafarge doing anything differently.

Impact of the joint venture

27. Breedon said that the joint venture could dominate national supply of stone with a high-PSV value of 60 to 65. The joint venture would have a significant share of rail-linked quarries in Leicestershire, which would dominate rail supplies to North London. The joint venture would also be a clear market leader in cement, aggregates, asphalt and RMX nationally, which would cause problems in certain geographical markets. While there would not be a reduction in competition in all areas of the country, there were several local areas where there would potentially be quite a significant reduction in competition (for example, South Wales).
28. Breedon added that if the joint venture was required to make asset disposals to get clearance, the CC should make sure that the disposals were not plants that had been previously mothballed or were in remote areas, but were of reasonable quality with at least ten years of operational life left and adequate transport links.