ANGLO AMERICAN/LAFARGE MERGER INQUIRY

Summary of hearing with Costain Group held on 30 September 2011

Background

1. Costain Group (Costain) said that it was a leading UK construction firm, providing construction services to various markets and industries. Although market conditions were tough at the moment, it was performing well and maintaining its profit margin. It was aiming to move its business into consultancy, design and facilities management as well as construction in the coming years.

Relationship with the parties

2. Costain told us that it was involved in a joint venture with Lafarge which provided road maintenance for the Highways Agency. Such joint ventures were not uncommon in the industry: they allowed companies like Costain to bid for projects for which they might not otherwise be able to provide a full service, while clients were reassured when receiving combined bids from two strong companies. Lafarge provided the materials (aggregates, fills, concrete and coated road stone or asphalts for road surfacing) which greatly simplified the supply chain.

3. Costain said that it also purchased aggregates, ready-mix concrete (RMX) and asphalt (along with asphalt laying services) from Tarmac and Lafarge, as well as from other suppliers, including Cemex, Hanson and Aggregate Industries. Costain had purchased these products from Tarmac and Lafarge for at least the last 20 years (as well as a range of other products, such as pre-cast concrete products, plaster-board and roofing tiles, which it now purchased from other suppliers).

4. The biggest cost factor with any of these products was distribution and transportation, particularly with road haulage. For example, aggregates transported by boat from a Scottish quarry to Essex would cost £1.50 a tonne, but subsequent road haulage could drive the cost up to £10 to £12 a tonne.

5. Costain said it would, as indicated above, have no issue with using alternatives to Tarmac and Lafarge if necessary. Costain used competitive tendering between the five major players to obtain best value, not favouring any one supplier, particularly for asphalt laying services.

6. Costain had considered producing its own RMX, but had rejected the idea due to the difficulty in attaining the right consistency and quality. Costain would have to apply for Quality Scheme for Ready Mixed Concrete (QSRMC) certification and it did not have the required quality management systems to do so.

Purchasing process

7. Costain told us that suppliers like Tarmac and Lafarge might increase prices, so it usually agreed long-term arrangements according to an agreed mechanism that took into account costs and volumes. Costain did not place orders without knowing the long-term price, and spot purchases were rare (usually to cover logistical issues arising in the course of regular contracted deliveries).

8. Costain said that it approached as many suppliers as possible for bids to supply on a particular project. The suppliers approached depended on the location of the project and whether they had the capacity and logistics capability to deliver required volumes. Costain added that it very rarely sourced from multiple suppliers for the same project. This was partially driven by economics—purchasing larger quantities was cheaper per tonne, so it was better to use a single supplier capable of supplying all requirements, rather than split requirements up into smaller batches from multiple suppliers. Smaller suppliers could therefore find it difficult to bid successfully.

9. Although it had occasionally found it difficult to get quotes from suppliers, Costain did not believe that collusion existed between suppliers in the market. One reason why a supplier might not quote was due to not being able to provide the required volume of materials as a result of commitments to other contractors. Further, Costain required significant volumes, which meant that suppliers sometimes had to bring in outside haulers; which could increase their cost base and make Costain's contract less attractive.

Market definition

10. Costain said that material engineers on site determined what was needed on a project, according to the design criteria of the client. While recycled aggregates could be used as alternatives to the primary aggregates, specifications were sometimes so tight that a specific product had to be used and that was often a primary aggregate. In some cases, Costain was able to use a combination of 90 per cent primary product and 10 per cent recycled product without affecting engineering qualities, but blending the two together actually added to costs.

11. Costain told us that it used Portland Cement (CEM I) and CEM II and CEM III for a range of activities, including tunnelling and making concrete. The principal consideration in terms of choosing which type of concrete to use, and whether substitution was possible, was the quality of product (ie how it hydrated and cured) and the technical engineering specifications of the project. Even when alternative cement products could be used, they might not be available from the supplier's plant.

12. Costain advised that it very rarely used volumetric trucks instead of RMX. It was again a question of the quality of the product; volumetric concrete was self-mixed by the operator, so it was difficult to determine the quality.

13. Costain said that it was unaware of mobile asphalt plants, although noted the use of higher volume trucks able to keep pre-mixed asphalt warm for a whole day. It also used asphalt supplied by 24/7 plants, as required by the timing of roadwork projects. Costain had no difficulty in finding 24/7 suppliers, but noted that supplies from 24/7 plants were more expensive.

14. When asked what Costain would do if a supplier of aggregate, RMX or asphalt increased its prices by 5 per cent, Costain told us it would review and discuss its contract with the supplier while looking for an alternative source of supply. However, since about the end of 2010, Costain's strategy had been to avoid this by having longer-term contracts (see paragraph 7).

15. Costain advised that with respect to aggregates, there was a 15 to 20 mile radius over which a supplier had an economic advantage. The area of advantage for asphalt and RMX was related to the time it took for the product to remain viable for use once mixed. Asphalt could generally travel up to 50 to 60 miles before it could no longer be used. However, RMX had about a 45-minute travelling time before it

started to separate, and the distance managed could be heavily affected by traffic density.

16. Costain noted in particular that the small geographic market for RMX meant that areas with a high volume of work had plenty of suppliers (for example, metropolitan areas), but plants in areas without such demand were just not sustainable or competitive to operate, leading, for example, to no Cemex RMX plants in the South-West and a consequent disappearance of competition.

17. Costain considered that competition for the supply of cement was limited in the UK and that supply was controlled predominantly by the major manufacturers. Importing cement was problematic due to exchange rate issues (particularly with the euro), logistics and reliability of delivery when needed.

18. With respect to competition between Tarmac and Lafarge, Costain said that it saw Tarmac as an aggregates company that also supplied some cement, whereas Lafarge was a cement company that also supplied some aggregates. Overall, Lafarge was higher in quality and higher in price.

Barriers to entry/expansion

19. Costain considered it would not be difficult for a new supplier of aggregates to enter the market and start supplying a customer like Costain, providing that the entrant met Costain's quality and logistics criteria and commercial position. The opportunity for new entry was increasing due to the growing use of recycled aggregates; the recycled aggregates market suited local providers more than the multinationals, which had a vested interest in providing primary aggregates rather than recycled.

20. Costain considered that it would be very difficult for new companies to enter the market for RMX without serious financial backing and support. A particular barrier to entry preventing competition was the vertical integration of the major suppliers—any new entrant might need to obtain the necessary cement and aggregate from its competitors.

21. Costain said that it currently imported cement from the Republic of Ireland and imported aggregate from Stema, a Norwegian company. Costain noted that the economics of importing aggregates was improved by the large volumes it required.

The counterfactual

22. Costain was aware that Anglo American had, over the last five years, been looking to sell Tarmac as the company did not fit in Anglo American's portfolio. However, it noted that Anglo American had maintained Tarmac throughout the period, and expected it would have done the same in the absence of the joint venture. It was also possible that one of the other five major companies might have been interested in pursuing a joint venture, or a foreign player looking to expand in the UK.

Views on the joint venture

23. Costain thought that Lafarge had missed much needed opportunities to expand through acquisition over the last decade and that, with Anglo American's aim of selling Tarmac, the proposed joint venture therefore made sense for both businesses. However, Costain noted that it had some concerns given that one out of just five major competitors would be removed from the market. Further, Costain raised the question as to why this was a joint venture, as opposed to an outright sale.

24. Costain raised specific concerns about the vertical integration of the supply chain for concrete as it would not be clear if the internal pricing of aggregates and cement would be subject to market forces. Further, it believed that there was already limited competition in the supply of cement.

25. Costain was also concerned about the provision of asphalt and concrete because aggregate was produced by both firms. Costain raised the possibility of plant closures in overlapping areas due to the current high level of excess capacity caused by the current reduction in demand. Costain noted that it seemed likely that the plants/ quarries would only be mothballed as this would allow them to be opened again when the market picked up (unless the plant was old enough for reopening to be too costly).

26. Costain said it had no concerns about the proposed joint venture between Tarmac and Lafarge in relation to asphalt laying because it was confident that the market would remain competitive. Costain's only concern about the joint venture was its possible impact on concrete, because the supply of aggregates and cement used to make concrete was limited to the five major players, including Tarmac and Lafarge. Therefore, a joint venture between Tarmac and Lafarge would restrict competition for aggregates and cement.