ANGLO AMERICAN/LAFARGE MERGER INQUIRY

Summary of hearing with Hillhouse Quarry Group held on 4 October 2011

Background

1. Hillhouse Quarry Group (Hillhouse) said that it was a wholly-owned family business based in Troon, Ayrshire, but with sites elsewhere and with activities extending into southern Glasgow, Dumfries, Galloway and South Lanarkshire. Its primary activity was quarrying hard rock, which it used to make ready-mix concrete, asphalt products and concrete blocks. It was also involved in the market for pre-cast concrete floors, stairs and landings, as well as contract surfacing. Its biggest customers were local authorities, while private sector work had declined due to the economic downturn. The housing sector had all but disappeared, so Hillhouse predominantly served the maintenance market, working for local authorities and on small housing projects.

2. Hillhouse told us it had seen a significant decline in turnover and profits since 2008, which was reflected across the construction sector and the UK. This was primarily due to the reduction in private house building and the decline in the general construction market. The outlook was flat with no general upturn in growth foreseeable over the next few years, particularly as cuts in local authority expenditure started to come through.

3. With respect to regulatory changes affecting its business, Hillhouse cited as foremost the Carbon Reduction Commitment, which had developed from an energy consumption trading scheme to, in effect, a direct tax on energy consumption. It also noted the aggregates levy soon to be £2.10 on every tonne sold and the landfill tax, which indirectly affected primary aggregate output through making it more attractive to sell secondary aggregates rather than dump them.

4. Hillhouse advised that it was a member of the Mineral Products Association (MPA). The MPA provided members with technical advice and support (on issues such as the environmental and health and safety regulations) as well as lobbying the Government on behalf of the industry.

Hillhouse as a competitor

5. Hillhouse told us that it produced a wide range of aggregates, which were sold for use in a variety of construction activities and which it used to make asphalt and ready-mix concrete. Hillhouse noted that where it had to buy in aggregates, rather than being able to use materials from its own quarry, added to the costs of any products made.

6. Hillhouse said that basic recycled aggregates reclaimed from demolition could be used as an alternative to primary aggregates. However, Hillhouse advised that specification could often be a barrier to using recycled products (for example, with respect to black top surfacing, where product specification and polished stone value was a significant barrier to their use). Further, there was also only so much demolition work at any one time from which to source recycled aggregates, so it could sometimes be hard to switch to supplying such products.

7. With respect to ready-mix concrete production, Hillhouse said that it used its own hard rock aggregate; with concreting sand supplied by Tarmac and cement by

Lafarge. The amounts of each depended on the required specification for the concrete. It did not use any recycled or secondary materials for ready-mix production, but did so for asphalt, where it used recycled road planings.

8. Hillhouse said that as an alternative to Ordinary Portland Cement (OPC) (also known as CEM I) it could use cement made with varying ratios of ground granulated blast furnace slag (GGBS) or pulverized fuel ash (PFA) (also known as CEM II and III respectively). Both products could be used for the same application; for example, Lafarge's proprietary PFA product, Phoenix, could be used for the same applications as a product from Heidelberg Cement (Hanson), which used large volumes of GGBS (Heidelberg Cement was the only UK source of GGBS). Both products were similarly priced, so availability determined which was used. Hillhouse added that OPC was the key driver in the purchase price of cement.

9. Hillhouse noted that ready-mix concrete and concrete from volumetric trucks were essentially the same product. However, volumetric trucks tended to be used only for small jobs such as farming and fencing-post work where specification was not a key consideration and there was no requirement that the work be carried out under QSRMC or BSI accreditation. Further, the trucks were very uncompetitive with respect to large-volume work because they provided only small volumes at high margins. Hillhouse added that the industry as a whole was concerned about the ability of volumetric trucks to run over weight due to how they were treated under road regulations, which was seen as handing them an unfair advantage. Hillhouse did not operate any volumetric trucks itself.

10. With respect to mobile asphalt plants, Hillhouse advised that such plants would only be used for contracts of a specific size and above, because the cost of moving a plant, installing, running and decommissioning it represented a substantial cost to a supplier. Hillhouse did not operate mobile asphalt plants itself.

11. Hillhouse considered that its main competitors for dry-stone aggregates were those companies with quarries in the same area, as the cost of transportation accounted for a large proportion of the delivered price. These included companies such as Barr Construction, W H Malcolm, Patersons, Tarmac, Aggregate Industries and Cemex. It noted that Lafarge was not well placed for aggregates in Scotland, only having five ready-mix plants and one cement works; this compared with a heavy presence in aggregates in England.

12. Hillhouse considered that the major companies (Tarmac, Lafarge, Aggregate Industries, Hanson and Cemex) along with Barr Construction were its competitors for ready-mix concrete and for asphalt. With respect to its asphalt plants, Hillhouse said it had consent to allow 24/7 operation, as did its main competitors. The cost of asphalt from a 24/7 plant was not necessarily more expensive, particularly if larger volumes were purchased. It noted that only around 10 per cent of jobs required the use of 24/7 plants (these tended to be jobs such as road maintenance which needed to be done at night).

13. Hillhouse's competitors for contract surfacing included a lot of independent contract surfacing operators, as well as the majors.

14. Hillhouse told us that it was economically viable to transport aggregates around 35 miles from the quarry, although it noted that the major companies transported aggregates internally across much larger distances than this. By contrast, asphalt products could easily travel 50 miles and in some instances up to 160 miles depending on terrain and weather and the ability to keep the product at the right

temperature. Ready-mix could travel up to 25 miles as it could not be kept in the mixer for longer.

Hillhouse as a customer

15. Hillhouse told us it purchased cement from Lafarge and sands for asphalt and ready-mix from Tarmac. Although it made it easier to have a single source for sand, Hillhouse had also sourced sand from Cemex on a reciprocal basis, with coarse aggregate going one way and fine aggregate going the other, thus saving on transport costs. Hillhouse advised that it also sometimes sold a small volume of coarse aggregate to Tarmac's asphalt business in Glasgow.

16. Hillhouse told us it was a customer of Lafarge and Tarmac because its options were limited in terms of available suppliers. Lafarge, Heidelberg and Cemex were the main sources of supply for cement in Scotland, while Tarmac's supply of cement was not possible to access as it was all accounted for. Paragon, another cement supplier, provided all of its cement to its parent, Aggregate Industries.

17. Hillhouse had purchased cement from Heidelberg in the past, but prices crept upward at such a rate that Hillhouse switched to Lafarge two years ago. Since switching, Hillhouse had not been able to obtain a quote from Heidelberg. Given that it had the supplies previously and was closer to Hillhouse than Lafarge, Hillhouse assumed that Heidelberg simply did not want to do business for some reason.

18. Hillhouse noted that in 2008 there was a shortage in cement, which resulted in price increases that had continued to occur to date. Hillhouse, however, believed that the shortage was down to a lack of alternative sources of supply rather than any real issues with, for example, the availability of clinker as it was told at the time.

Purchasing process

19. Hillhouse said that it agreed on a cement price with Lafarge on an annual basis. In the two months leading up to the end of that 12-month period, it looked to renegotiate the price for the following 12 months. This negotiation process involved talking to around three other potential suppliers. With respect to sand, Hillhouse advised that it was restricted from considering other suppliers on the basis of geography, as there were not many sand and gravel suppliers in its area. It regarded the prices it paid for sand and cement as transparent, as it understood the cost justifications for any price increases. However, Hillhouse did note that all the major companies increased their prices at around the same time by about the same amount.

20. On the process by which customers purchased products from Hillhouse, Hillhouse advised that supply of asphalt products to local authorities was mainly through six-month or yearly contracts, where rates were fixed for that period. For ready-mix, supply was via a framework contract that bound parties for up to four years with price indexation across all projects. There was also the general or third party market where prices moved more regularly, but normally Hillhouse tended to commit itself to a fixed price for a year. However, where major costs went up (particularly bitumen, a major cost factor for asphalt), it would try to move the price within a couple of months although this lag meant that Hillhouse sometimes found itself with a loss of margin for the period.

21. Hillhouse noted that it was not often aware of the prices charged by its competitors, although in the case of aggregates there was a generally acknowledged market value from which to work off.

Barriers to entry/expansion

22. On aggregates, Hillhouse noted that geology dictated the location and availability of mineral resources, and they were often not sufficiently near the main conurbation areas to become economic sources of supply. Hillhouse told us it was planning to produce its own sand and was hopeful this venture would be successful. It noted that the industry was aware that there was shortage of sand and gravel in the long term and that planning authorities were aware of this.

23. Hillhouse said that producing its own cement would be too expensive. It was very difficult for small operators to get involved in cement production due to the cost of the plant and the processes, which could run into hundreds of millions of pounds. Although Hillhouse could import cement, Cemex, Lafarge and Heidelberg were large multi-national organizations with significant cement capacity throughout the world, so any cement imported into the UK would mostly be sourced from those companies anyway.

24. By contrast, with a reasonable amount of expertise, anyone could set up a ready-mix concrete or asphalt plant, but would need to source fine and coarse aggregates and, the case of ready-mix, which was the key element to ready mix. If the cost of cement was prohibitive, then it would be impossible to set up a ready-mix plant, even with an in-house supply of aggregates.

The counterfactual

25. Irrespective of the joint venture taking place or not, Hillhouse considered that there would be a reduction in capacity in the market on top of that which had already occurred due to the economic downturn, with further consolidation between operators whether through joint ventures or asset disposals. The key concern for small and medium enterprise companies if this occurred was that the major operators would continue to increase their market share and look for the best possible price

Views on the joint venture

26. Hillhouse also expressed concern about the consolidation of two cement producers when there were so few cement producers in the UK. This would reduce Hillhouse's cement-buying options and could result in an increase in the price of cement. Further, it noted that the combination of Lafarge's five and Tarmac's 12 or more ready-mix plants could lead to control of the ready-mix concrete market in the central Scottish belt. It also expressed concern that the joint venture's large cement resources could allow it to engage in predatory conduct with respect to ready-mix concrete. Hillhouse would not be able to compete on price because would not have the cost structure to support lower pricing.

27. Hillhouse added that if there were to be a divestment process as a result of the joint venture, the Competition Commission needed to ensure the right assets were disposed of to ensure that the eventual structure did not allow Tarmac and Lafarge to control key geographical areas in Scotland.