

BREEDON AGGREGATES/AGGREGATE INDUSTRIES UK MERGER INQUIRY

Summary of a hearing with Leiths held on 4 November 2013

Background

1. Leiths was created in 1972 as a small family business and purchased its first quarry in 1978. It now owned 16 quarries and had acquired a number of smaller aggregates companies over the years. It had also expanded into specialist areas including demolition and asbestos removal and road marking and planing. As the company had grown it had got more involved in construction and surfacing, primarily with the objective of laying its own materials.
2. The last five years had seen lower profits than before 2007, which was when the recession hit the construction industry, but Leiths was more positive about profits increasing over the next few years, particularly with the construction of the Aberdeen bypass starting in 2015. There were also plans to upgrade other major roads in north Scotland from 2014, so infrastructure spend in the Highlands and Grampian regions should increase as a result of government expenditure.
3. It was uncertain whether aggregates for the Aberdeen bypass would be bought from local quarries or whether borrow pits along the line of the route would be used. Leiths expected that mobile asphalt and concrete plants would be used and that these would be supplemented with products from local suppliers. However, it emphasized that it would be focusing on its traditional local customers first so that capacity would not be diverted from its core market. Even if it did not play a major part in the Aberdeen bypass contract, it expected to be busy over the next two to three years.
4. Leiths' customers ranged from very small operators who purchased only limited amounts to major civil engineering contractors. [REDACTED]

Market definition and competition

5. Leiths supplied aggregates, coated stone, ready-mix concrete (RMX) and asphalt. In terms of recyclable materials, these were mostly processed on the demolition sites and then reused on the site, so the amount of recycled aggregates that Leiths supplied was very small. It did not produce secondary aggregates.
6. Leiths produced primary aggregates for general construction purposes. These products were the same across the market as all aggregate producers adhered to the same British Standard (ie commodities). It believed that price was the key component in the sales process.
7. There had been an increase in the use of RMX for small-scale paving in recent years, largely as a result of the rising cost of bitumen which was used in asphalt production. Whilst at present the number of occasions when RMX was chosen instead of asphalt was rare, it was increasing. Leiths believed that the two products could be increasingly substitutable but that the limiting factor was that whilst RMX was cheaper, it took 28 days to set. There were also more weather restrictions for laying RMX than asphalt as asphalt could be laid in a wider range of temperatures. Leiths had no volumetric trucks and had no plans to buy any. It said that volumetric trucks could not readily produce British Standard mixes and so could not be used to produce structural concrete where the quality of the product was important. Within

the Inverness area there were a handful of volumetric trucks but Leiths did not think they posed a significant constraint and they only provided competition at the lower-quality end of the concrete market.

8. Leiths did not have any mobile concrete plants, but some had been used by others, for example to supply the contracts for the wind farms in the Grampian and Highland areas. It felt that it had missed out on the opportunity to bid for these contracts but speculated that the reason the companies had chosen to opt for mobile plants was the remoteness of the areas in question. The projects would need large volumes of concrete delivered in a short space of time and therefore having plants on site or local to the site would be more convenient.
9. In the North-East of Scotland there were few jobs that would justify the cost of a mobile asphalt plant. It thought that a contract would have to be in excess of 10,000 tonnes to make it worthwhile and therefore, aside from the Aberdeen bypass, there was not much of a challenge normally from mobile asphalt plants. Leiths thought that 24/7 plant operations were not really a consideration in north-east Scotland. Most plants were constrained by planning permission and special derogations were needed to extend plant working times.
10. Leiths believed that a rise in prices for asphalt of 5 to 10 per cent could result in a greater use of RMX. However, in terms of aggregates, it did not think that a change in behaviour would result. A rise in the price of RMX might result in a reduction in demand as decisions could be taken to reduce the scope and scale of projects.
11. For asphalt and concrete, Leiths' main competition came from Breedon and Aggregate Industries, but in the aggregates market there was more competition as there were also a number of smaller independents. However, these companies tended to compete more at the lower-quality end of the market and so focused on basic fills and layers to go under better-quality materials. They did not produce quality aggregates for the RMX and asphalt market. Aberdeenshire Council had three quarries, but tended to serve its own internal needs.
12. The average distance for the supply of aggregates tended to be 30 miles for quality aggregates, and less for fills. However, this would depend on the area: around Aberdeen and Inverness it was likely to be lower on average, whereas in the Highlands it was higher because of the nature of the road network.
13. Most plants were operating well below capacity on average across the day but Leiths' plants frequently operated at full capacity in the morning peak. Presently demand was always greatest in the mornings when surfacing or concrete gangs were starting work because concrete and asphalt had to be laid within 2 to 3 hours of leaving the site; demand then dropped off during the day. Customers were limited in their ability to order evenly throughout the day by daylight hours and temperatures which also impacted on the timings for the material to be placed and set.
14. The two main parties offered competition in terms of surfacing, though competition also came from the Central Belt of Scotland and Ireland, in particular on large contracts.
15. Decorative aggregates were supplied by Leiths' Skye and Mid Lairgs quarries and were distributed by merchants to pebble-dashing contractors and horticultural customers. While Breedon and Aggregate Industries competed with each other as they both supplied red granite, Leiths' decorative aggregates were white and were not in competition with the red granite, which was mostly used for highway works. Decorative

aggregates tended to travel much greater distances and commanded higher prices than other aggregates.

Recycled aggregates

16. Recycled aggregates could not be deemed a suitable alternative to primary aggregates as they were of lower quality. They could not be used in asphalt surface layers as there was a risk that they could have been contaminated with other materials, such as wood or steel, and whilst they could be included in poorer-quality concrete, they would not be used for structural concrete. Hence they were mainly used as a base layer or in general fills, for example to fill in a trench or for a concrete base for a shed.
17. The trade association had estimated that recycled aggregates represented 25 per cent of the total supply of aggregates in the UK. Leiths thought that the proportion would be lower in the Aberdeen area as there were not many demolition contracts with a surplus of materials and a higher percentage of aggregates went into the production of added value asphalt and RMX.
18. Leiths understood that the £2 per tonne aggregates levy was being challenged in the European courts. [✂]

Leiths as a customer/vertical issues

19. Vertical integration meant that value was added to aggregates. Whilst lots of people could produce aggregates, the value came from adding cement or bitumen to aggregates to make concrete and asphalt. An aggregates-only business was unlikely to generate high profit margins.
20. Leiths' priority would always be to supply its RMX and asphalt businesses, ie to maintain vertical integration, even if the price of aggregates in the outside market were to increase substantially.

Purchasing process

21. Long-term contracts were unusual and most work was won based on the price given after an enquiry. Leiths was only involved in one long-term contract through its asphalt surfacing operations. Jobs were won on price, although quality and service could be a consideration.
22. The pricing of products was based on a number of factors, including: the area, product type and the creditworthiness of the customer. If a contract had been lost, prices could be adjusted next time, though there was a minimum level below which Leiths would not go.
23. Leiths had its own delivery fleet across all products and it would offer a collected price or a delivered price. Whilst people could readily collect aggregates and asphalt, this was more difficult for RMX, so the vast majority of RMX was delivered using truck mixers.
24. Leiths' knowledge of the pricing levels of competitors was based on market intelligence. It did not spend a lot of time trying to work out what other companies were charging for haulage and the products, but rather looked at the delivered price as it was that that would determine whether it would win or lose a contract. However, it had major concerns with the merger regarding asphalt because the main cost ingred-

ient was bitumen and the larger the amount purchased, the better the price. Leiths was concerned that because of its size the merged entity would benefit from better prices from bitumen suppliers.

25. Leiths believed that asphalt prices were higher north of the Central Belt, as one supplier controlled the entire bitumen market. Prices would be higher in the Grampian and Highland areas as there was less demand in the North of Scotland than in the Central Belt, where a smaller number of plants produced very large volumes. In the North of Scotland there were more plants producing much smaller volumes. If a national or international consortium won the contract for the bypass, it would be able to demand a national/discounted price for bitumen.

Entry and expansion

26. For aggregates, planning permission was a barrier to entry for new operations as local authorities were unwilling to grant permission for greenfield sites.
27. Local authorities tended to grant permission based on land banks, and they would not grant planning permission beyond, for example, ten years. This meant that any company with large reserves which already had planning permission in place tended to be in a very strong competitive position as local authorities were unwilling to grant additional permissions within this time period. With Breedon and Aggregate Industries merging, they would not only have a dominant position in aggregates in Aberdeen, but also a dominant position in terms of the reserves in their portfolio.
28. For asphalt, the main barrier to entry was a sufficient source of quality aggregates to justify an asphalt plant costing over £3 million. Mobile RMX plants were cheaper and hence an RMX business could be set up at a much lower cost, providing there was a source of quality aggregates. Operational costs for the latter were also lower. Cash flow in the early stages of both asphalt and concrete businesses was also a constraint: customers would have 60 or 90 days' credit, while payment terms for bitumen and cement were much less favourable.
29. Most quarries in Scotland operated differently from England where they invested in 'static' processing plants. In north Scotland, the quarries tended to work using mobile processing equipment and would crush and screen what they thought the market demand would be for the coming months, as opposed to working on a daily set amount. Therefore if it was believed that market demand was likely to increase suddenly, the mobile processing plants could increase their capacity levels potentially threefold by adding more equipment. RMX and asphalt plants were more fixed and had a rated capacity per hour.
30. Leiths had made an investment of £[X] into an RMX plant in Dufftown, which would have a capacity of [X] cubic metres per hour once operational. It had been under construction for approximately four months, though this was with planning permission in place, otherwise it could have taken a year. Planning permission for a concrete or asphalt plant could take up to three years.
31. The availability of specialist delivery vehicles for RMX could also prove an issue if the market expanded quickly as it was not possible to hire them: they had to be bought. With a typical lead-in time of four months for purchasing new vehicles, it was quite difficult to respond to changes in demand for RMX. The same constraints did not exist for asphalt as the same vehicles were used as those which delivered aggregates.

32. Another barrier to entry in the supply of RMX and asphalt was that the right quality of aggregates was needed to make such products.
33. In the north of Scotland, there was only one major producer of RMX which did not own a quarry—Hope Construction Materials.
34. Buying in aggregates from third parties was not practical as these suppliers would be seeking a margin, and there would also be the additional costs of hauling them from their quarry to the plant. Leiths always ensured that it sourced its aggregates in-house, even if it had to bring them in from one of its other quarries. Whilst there was the issue of cost, it also emphasized that concrete and asphalt were highly-specified products and therefore it was necessary to ensure that the ingredients going into them were of a good quality.

The counterfactual

35. Leiths said that it had expressed interest in buying the Tom's Forest plant and it had spoken to Aggregate Industries about a variety of packages around Aggregate Industries' quarries in the North of Scotland and the Islands. It had tried to buy the Mid Lairgs asphalt plant, but had been told that it would also have to take the Beaully quarry. Some information had been given to Leiths, but the negotiations had not been taken forward by Aggregate Industries. Leiths then got a letter from Aggregate Industries' lawyers asking it to assign the lease on Mid Lairgs to Breedon. Leiths had refused as it did not want a major competitor to be situated on one of its quarries. [REDACTED]
36. Leiths had expressed an interest in a package of sites across the North of Scotland because it also wanted to get into the Scottish trunk road market. It could not compete in this area as it did not have the geographical coverage to bid for the contracts, and now that the sites had been sold to Breedon it would be almost impossible to compete for Transport Scotland's contracts.
37. Leiths said that contracts issued by Transport Scotland were subject to a competitive tendering exercise above £350,000. [REDACTED]

The merger

38. The merger would give Breedon a dominant position in Aberdeen, in both the concrete and aggregates markets. In Inverness, Breedon would have a dominant position in relation to coated stone.