

**AGGREGATES, CEMENT AND READY-MIX CONCRETE
MARKET INVESTIGATION**

Summary of initial hearing held with Aggregate Industries on 16 May 2012

Background

1. Aggregate Industries (AI) was part of the Holcim Group, which was one of the largest international groups in the construction materials sector with operations on five continents. In the UK, AI produced and supplied construction and building materials, including aggregates, asphalt, ready-mix concrete (RMX) and other concrete products. AI did not produce cement in the UK, but it did import it and purchase it from UK-based manufacturers.
2. AI operated a decentralized management structure which was intended to enable its local managers to respond quickly to changes in market conditions. However, each of its business divisions was responsible for meeting a financial target agreed by AI's Executive Committee. The Executive Committee was also responsible for the overall management of the business and dealt at a strategic level with matters such as business performance and capital investment.
3. AI had approximately 13,000 customers who ranged from large construction multi-nationals to individual persons. Its customer base could be broadly categorized into four groups:
 - Very large major projects, which typically lasted six months or more, and required a wide range of different products and at least 25,000 m³ of RMX (eg Crossrail, the Olympics).
 - Smaller major projects, these usually involved repeat customers who required a wide range of products (eg highways, buildings).
 - Fixed-point-of-construction customers, who tended to require the regular delivery of a narrow range of products.
 - Casual customers who typically made one-off purchases of small amounts of material (eg individuals laying their own concrete driveways).
4. AI sought to distinguish itself from its competitors through innovation and by offering its customers high-quality products that met their needs at attractive prices. Maintaining good relationships with customers was a priority.
5. The aggregates and RMX markets had been severely affected by the economic downturn. AI's main customers were involved in markets that had been affected by the fall in infrastructure spending. [X] There had also been significant increases in the production costs, particularly for fuel and energy, for these products. Increased taxation such as the aggregates levy and carbon taxes had also raised costs.
6. The UK economy had again recently slipped into recession and current economic forecasts were not predicting any growth or recovery until at least 2015. Holcim had recently publicly announced a new cost-cutting plan in order to improve the group's profitability. Holcim needed to achieve an overall return on investment (after tax) of 8 per cent, while AI's operations were only currently achieving a 2.7 per cent return (before tax).

7. A combination of lower demand for its products and increased customer choice had created intense competitive pressure in AI's product markets. In response, AI had focused on the most profitable parts of its business and had reduced its expenditure and costs to adjust to the fall in demand. It had reduced its workforce from 6,500 to 4,600 full-time employees since 2007. It had considered reducing the number of its suppliers in order to achieve better economies of scale and increased value. It had also worked to improve the quality of its customer service. These measures had not yet alleviated the difficulties AI currently faced.
8. AI faced strong competition in the aggregate and RMX markets in Great Britain both nationally and locally.
9. In aggregates (including primary, secondary and recycled aggregates) AI faced competition from the other majors and independent suppliers. There were four or more competitors' sites within a 22.5-mile radius (which AI regarded as a conservative measure) of almost all of AI's aggregates sites and at least one of these competing sites would be independent of the majors.
10. There was a very similar situation in RMX. Again, AI's RMX facilities faced competition from four or more competitors' sites within a 22.5-mile radius, and again at least one of these sites would be independent.
11. This meant that in both the aggregates and RMX markets, customers had a wide choice of suppliers at a local level and had the ability to source from a number of suppliers, which increased competition between those suppliers. Aggregates and RMX markets were local in nature, so the challenges they presented varied from area to area. This made it impossible to make generalizations about the overall UK market.
12. The UK aggregate and RMX market was one in which it was very difficult for suppliers to make a sustainable profit, even with strong financial discipline and commercial management. The market conditions did not permit aggregates or RMX suppliers to try to make excessive profits at their customers' expense.
13. AI had worked to increase the value of its products. It had introduced lower-carbon products. It provided RMX products to meet specific customer requirements and had special delivery services for asphalt and RMX. AI's facilities had good access to the rail network, so it could easily move very large quantities of aggregates, and this had been crucial in AI winning bids to supply construction materials to the Olympics.
14. Rather than focus only on its products' attributes and their prices AI sought to use its experience of supplying building materials to provide a combination of its products and services that would meet its immediate and ultimate customers' needs and objectives, whether these were cost, speed of build, or sustainability (eg the use of secondary aggregates on the Olympic site). In this way, AI tried to distinguish itself from its competition by de-commoditizing the products and services it offered.
15. AI had engaged in very few sales or purchases of business assets with either the other majors or independents, but it was currently disposing of uneconomic assets or closed sites. It was aware that CEMEX and Hanson had sold aggregates operations in Scotland. AI had developed its RMX presence in Greater London and in other areas by growing its business rather than through acquisition.

Aggregates

16. Apart from sales from its rail-linked quarries, AI found that 85 per cent of its aggregate sales from rural quarries were made within a 50-mile radius, while in urban areas most sales were within a 30-mile radius. Even if the narrower radius of 22.5-miles were used, AI's customers still had the choice of four suppliers.
17. Customers were increasingly able, willing and prepared to use secondary and recycled aggregates. Secondary and recycled aggregates now accounted for between 25 and 30 per cent of the current market and were a substitute for primary aggregates in the vast majority of cases. AI used secondary aggregates in its own production of RMX and other products. Customers wishing to use lower-carbon products encouraged the use of recycled and secondary aggregates. Improved technology and processing produced higher quality recycled aggregates which were competitive in quality terms against primary aggregates. London was the biggest single market for non-primary aggregates with about 40 per cent of all the aggregates used in general construction being recycled. Where possible AI's RMX and other businesses used recycled aggregates as they were cheaper.
18. Customers increasingly wished to use recycled materials, and suppliers were finding new ways of ensuring a steady supply of material. This greater use was likely to make recycled materials more valuable.
19. In terms of availability, AI said that in Cornwall and Devon alone there was about 600 million tonnes of secondary aggregates already available with about 40 million tonnes more being generated a year. AI transported some of this material from west Cornwall into London by ship and by rail, and said that similar opportunities might be available in Wales. Recycled aggregates could be made from any type of concrete product as long as the material was properly processed so that any contaminants were removed.
20. The sales process for aggregates varied on the size of the order and the project for which the material was required. Large projects usually involved closed bid tendering processes, which might also include prequalification requirements. AI would likely need to talk to the tendering party in order to show that it was capable of meeting the tender requirements. However, tendering for aggregates was relatively rare (AI dealt with around 30 tendering processes a year). Most orders arose from customers contacting AI's sales teams for a quote.
21. AI set prices for aggregate orders by using a price list from which a starting price for an order could be calculated. AI would then negotiate with the customer. AI needed to make sure it could fulfil the order and do so in a profitable way. More junior AI salespeople could offer small discounts, while more senior AI staff could offer larger ones. AI did not usually have a regular point of contact for its main customers as its main customers (eg Balfour Beatty) might have a number of different employees contact AI. Its sales representatives did have knowledge of particular territories, so would normally handle orders for that particular area. Relationships with customers were important, but customers were most concerned about price.
22. AI would notify its customers of price increases routinely, usually annually. AI would inform its customers of the increase in price per tonne it was seeking, and would then enter into individual negotiations with its customers. AI never achieved the whole of the price increase it was seeking.

Ready-mix concrete

23. AI's RMX business was no longer as profitable as it had been prior to the economic downturn. AI based its internal transfer prices for materials for RMX on the overall market prices for them. Having a vertically integrated business was important to AI as it allowed it to better understand its customers' needs. It also enabled it to ensure the quality of the materials used in making its products and allowed it to better manage their supply, which was particularly important on very large projects, such as the Shard.
24. AI regarded the RMX market as extremely competitive with many alternative suppliers competing in small geographic markets. It said that 85 per cent of its RMX volume was delivered within a radius of 8 miles to customers who had a choice of three or more suppliers. Demand for RMX was the major factor in determining how competitive a particular local market was. Where demand was higher RMX producers had a better chance of making a sustainable margin. Entering and exiting the RMX market was relatively inexpensive, so it was a relatively low-risk business to start. It was noted that despite an overall 40 per cent decline, there were still independent RMX producers entering the market.
25. Independent RMX suppliers, including fixed-plant and volumetric truck operators, were a real competitive threat. Volumetric trucks were fully competitive with fixed RMX plants and now accounted for about 10 per cent of the RMX market. Fixed-plant suppliers were also strong competitors, and fixed plants had been built recently in a number of areas, including London and the South-East. Independent suppliers could operate more flexibly than large companies like AI, which had to comply with very high standards in aspects such as safety, quality and sustainability.
26. AI had tried twice in the past six years to operate a volumetric truck business, but for various reasons had been unable to achieve a viable return in both attempts. It had better success using its mini-mix solution to deliver small loads of RMX to customers who were looking to purchase in that way.
27. RMX sales happened in a similar way to sales in aggregates. There were some tenders, but most prices were arrived at through negotiations with purchasers. AI also priced RMX in a similar way to aggregates, using a system of pricing lists and a hierarchy of authorization levels for negotiating discounts. It differed slightly from aggregates because of the very local nature of the markets and the way this was reflected in how delivery costs and margin were reflected in prices. Discounts could be based on the size of orders and also the method and ease of delivery, as certain delivery patterns were more expensive than others.
28. Where it could AI would try to encourage customers to buy a branded value-added RMX product (eg self-levelling concrete) in order to meet customers' requirements as sales of these products were more profitable. Sales of value-added products accounted for approximately 30 per cent of AI's RMX sales in the past year.
29. Some of AI's customers were developing the capability to make their own RMX. In some cases, large construction companies would simply build their own fixed plants, while in others alternative suppliers, such as street cleaners, could use the material they collected as an aggregate substitute to make RMX.
30. In many cases, it was possible for customers to buy the additives required to make value-added RMX products, and some did so, but customers did not have the expertise of a company like AI in making these products and supporting customers in ensuring their correct use.

Cement

31. In order to provide lower-carbon RMX products, AI purchased ground granulated blast furnace slag (GGBS) from the sole UK domestic supplier as well as importing it. It had been cheaper for AI to import GGBS for use in Scotland, elsewhere it used domestically produced GGBS. AI was comfortable that it could obtain domestically produced GGBS if it required it. AI also used pulverized fuel ash (PFA) and had contracts with two power stations for its supply. It used much more PFA than GGBS in its products as PFA was much easier to blend with cement at its RMX plants. AI did not blend either GGBS or PFA with cement at an earlier stage to produce CEM II or CEM III products.
32. As AI did not produce cement in Great Britain, it needed to import it or purchase it from Great-Britain-based producers. It met approximately 50 per cent of its cement requirements through imports. AI did not believe that this disadvantaged it in any way. Not having Great-Britain-based cement plants meant that AI was spared the burden of making the large capital investments needed to construct and maintain them. AI currently obtained all the imported cement it required from Holcim's sea-connected facilities in northern Germany. The price AI paid for Holcim's cement was based on an internal 'international trading price', which was based on competitors' cement prices and was used by Holcim's own cement trading company. AI sold little cement in Great Britain and currently used what it imported in its own operations, but if there were to be decreased demand elsewhere in Europe, then AI might consider importing more Holcim cement.
33. AI did not have any exchange deals with a Great Britain cement producer where it supplied cement to the producer's RMX plants in one area while the producer supplied AI RMX plants in another. To determine how much cement it would have to buy from Great-Britain-based producers, AI would find out how much cement it could obtain from Holcim and then seek to buy the balance from domestic producers. AI would indicate to cement producers how much cement it needed and the specification. It would then negotiate with the Great-Britain-based producers and award a supply contract to whichever one it thought appropriate. AI would use Holcim's 'international trading price' as a reference point in these negotiations.
34. AI was not sure how phase three of the EU's emission trading scheme (ETS III) would affect cement producers, as it was not itself in that market. AI had paid around £3.5 million in carbon reduction tax in the past year.
35. AI did not see any evidence to support the idea that the major cement producers in Great Britain were coordinating their activities. AI had negotiated aggressively with all of them when procuring cement and believed that it had obtained cement from them at competitive prices as it could compare them to the Holcim internal international trading prices.

Joint venture remedies

36. The Great Britain aggregates, cement and RMX markets were already very competitive, and AI did not expect the joint venture between Tarmac and Lafarge and the divestment of assets required by the Competition Commission's remedies to make them significantly more competitive.