

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

Summary of initial hearing held with Tarmac on 11 May 2012

Background

1. All of the Tarmac businesses were currently owned by Anglo-American plc. There were a number of separate businesses under the Tarmac name. In the UK Tarmac Group Limited produced the products (aggregates, cement and ready-mix concrete (RMX)) covered by the Competition Commission's (CC)'s investigation ('the reference products'). Tarmac Group Limited also had a business unit based in Dubai which conducted its joint venture (JV) operations in the Middle East. There was also a separate Tarmac business in the UK called Tarmac Building Products which produced heavy building materials such as concrete blocks and mortar. Anglo-American intended to sell all of the separate businesses in due course, but only Tarmac Group Limited's UK operations excluding Tarmac Building Products would be contributed to the JV with Lafarge.
2. Tarmac considered that the timing of the Office of Fair Trading's reference of the cement, aggregates and RMX markets to the CC was surprising as it came during a long and deep economic downturn. Since 2007 demand for aggregates had fallen by 27.5 per cent. Production of cement in Great Britain had fallen by nearly 35 per cent, and demand for RMX had fallen by nearly 40 per cent. The economic conditions had forced Tarmac to make substantial cost savings, including reducing headcount by [REDACTED] per cent across its UK businesses since 2007. Tarmac had also closed or mothballed [REDACTED] facilities in Great Britain. [REDACTED]
3. In recent years Tarmac had faced increased competition from a number of new sources, including independent RMX volumetric truck operators, fixed RMX plant operators and cement importers. The combination of the reduction in overall demand for the reference products and the increase in competition had led to significant overcapacity in the markets for the products. Prices for the reference products had fallen in real terms, [REDACTED].
4. Tarmac's aggregates business required high levels of capital investment and had high levels of fixed costs. The aggregates markets Tarmac served were localized and fragmented, and it faced competition from a wide range of major, regional and local aggregates suppliers across all types of aggregates, including primary, secondary and recycled aggregates. Tarmac further noted that the aggregates market was characterized by excessive capacity.
5. Tarmac's cement business's output was almost entirely used by Tarmac to supply its own RMX business. It sold little cement externally but noted that it faced competition from Great-Britain-based producers and importers when it did make external sales.
6. Tarmac regarded the RMX markets it served as very localized and fragmented. It faced increasing competition from independent RMX producers and suggested that this showed that independent RMX producers were not subject to the disadvantages that larger integrated producers such as Tarmac faced, such as requirements for high levels of capital investment and costs in its aggregates and cement operations, which meant that Tarmac had been less able to flex its asset and cost bases in response to the reductions in demand which had occurred in recent few years. [REDACTED]

7. Looking forward, Tarmac expected the UK construction sector to decline further in 2012 and 2013 and did not foresee any recovery occurring until at least 2014 at the earliest.
8. Tarmac tried to differentiate itself from its competitors [REDACTED].
9. Tarmac noted that the remedies resulting from the CC's inquiry into the Anglo/Lafarge JV would have a significant effect on the overall structure of the reference markets, particularly cement and RMX, and asked that the CC take these effects into account in its investigation of the reference markets.
10. Since the economic downturn, Tarmac had approached the markets from a perspective of providing its major customers with solutions to their needs rather than simply selling products to the overall market. This included [REDACTED]. As noted above, Tarmac had also worked to reduce its costs, and it had done so by [REDACTED]. Reductions in demand for its products had led Tarmac to address its production overcapacity, which as noted above had meant closing or mothballing a significant number of plants. Tarmac had also sought to address its overcapacity problem through [REDACTED].
11. [REDACTED] It particularly noted that it had lost business to small independent RMX companies, which were also able to pick up jobs that [REDACTED].
12. Vertical integration allowed Tarmac, as a large company, to operate a rational and effective business model which enabled it to achieve efficiencies in its internal supply chain by turning raw materials (aggregates and cement) into finished products (RMX). While this version of vertical integration worked well for large companies like Tarmac, smaller independent producers tended not to vertically integrate in the same way but had nevertheless grown share in recent years with a different business model. Instead, a small aggregates or RMX company might offer a range of 'spin-off' services, such as skip hire, haulage, earthworks removal, demolition, or recycling to complement its aggregates or RMX businesses.
13. There were a number of reasons why participants in the market entered into JVs but usually it was to allow parties to share investment, particularly on aggregates (nine out of Tarmac's ten JVs (relevant to the reference products) involved aggregates, the other concerned RMX). In production-only aggregates, JV parties would work together to develop a site but would then compete for sales of the material produced on it. There had been a move towards asset swaps between participants in the market rather than regular sales and purchases of assets because of the generally reduced access to capital. However, asset swaps were rare since both parties would want to obtain assets they each needed and this was often difficult to arrange. Tarmac had sold a number of facilities to individual operators and to other major companies. These sales were often motivated by wishing to 'tidy up' its portfolio of assets (for example, by divesting non-core assets).

Aggregates

14. Recycled/secondary aggregates accounted for roughly 50 per cent of the market for general constructional foundation and fill grade aggregates and around 30 per cent of the whole aggregates market. Recycled/secondary aggregates could be used in the production of RMX, concrete blocks, asphalt, value-added aggregates and fill aggregates. Tarmac noted that primary aggregates competed very vigorously against recycled/secondary aggregates. Where construction companies could access and use recycled/secondary aggregates, they tended to do so. Demolition companies would often supply crushers to produce recycled aggregates on site.

15. Tarmac noted the difference between recycled aggregates (eg aggregates obtained from a demolished building) and secondary aggregates (ie aggregates obtained as a by-product from another process, eg slag from iron and steel processors and waste from china clay production). Both recycled and secondary aggregates were not subject to the aggregates levy. The fact that secondary aggregates were obtained from other industrial processes meant that there was a steady supply of them, whereas the supply of recycled aggregates was more dependent on the amount of demolition and new construction being undertaken. It was likely that the number of sources of recyclable material would increase when the economy recovered.
16. Quarries for primary aggregates could only be located where rock or sand and gravel were found. The area located below a line from the Wash to Dorset typically did not have rock quarries. Rock quarries were found to the north of that line. Sand and gravel were found in pockets throughout Great Britain. If additional aggregates were required in an area like the South-East (for example due to high demand), it would need to be transported there. However, Tarmac noted that different types of aggregates could be used for the same end-use application, for example crushed rock and sand and gravel could both be used to make most types of concrete and asphalt. It was very much dependent on what was available locally.
17. Tarmac's aggregate business was split into four regions (North and Scotland, Central, West and South-East). The commercial arms of each of the regional divisions would engage with their markets on as local a level as possible. Tarmac noted that markets were local and the material did not go very far because of the costs of haulage to get it to the customer. The dynamics in each local market would vary depending on factors like the number of aggregates producers present in each of them. Customers would negotiate to obtain the best prices they could. Generally, more populated areas had higher levels of demand, and the amount of demand would influence the quantity and number of sources of primary aggregates in an area. Recycled aggregates producers were using new technology to produce more material which could be used instead of primary aggregates.
18. The new National Planning Policy Framework document would be likely to encourage local authorities to promote the use of recycled and secondary aggregates in order to reduce the demands on primary aggregate sites in their areas. Customers usually did not require specific types of aggregate, instead they would ask for aggregate grades that met a particular specification, ie for aggregates that were fit to perform the function required of them. It did not matter to them if the aggregates were primary or recycled/secondary, so long as they were fit for purpose. Developers were incentivized to promote sustainability so would often prefer to use recycled or secondary aggregates when possible. It was, however, difficult for Tarmac to charge customers more for sustainable materials.
19. A large proportion of Tarmac's aggregates production was used internally by it in the production of RMX and asphalt. At the local level, Tarmac faced strong competition and had found it difficult to compete against recycled and small aggregates producers. It did, however, sell a significant amount of aggregates externally. The sales process was fast-paced and involved a number of aspects such as the volume of material required, the deadline for delivery, and the ability and the preparedness of the customer to pay. Tarmac faced experienced customers, who were used to putting out multiple enquiries and focused on getting the best terms possible. [✂]

Cement

20. Bagged and bulk cement served different markets. Bagged cement was generally for small projects where less strength was required. Often bagged cement was CEM II

grade cement, which included a higher proportion of limestone. This type of cement was less strong than other grades but was cheaper. Tarmac produced very little bagged cement. This was because it had taken a decision to use its production capacity to self-supply its RMX business with cement. Bulk cement was more suitable for supplying RMX plants as it could be moved and stored much more easily at an RMX plant than bagged cement.

21. [REDACTED]
22. There were now 27 cement import terminals in Great Britain of which 16 were owned by companies which did not produce cement in Great Britain. Five of those 16 terminals had opened since the start of the economic downturn. Often these new entrants were UK-based consumers of cement themselves that had decided to obtain control of a cement source of their own. Imports of cement were entering Great Britain because they were produced in areas of the EU with significant excess capacity, for example Ireland and Spain. The Emissions Trading Scheme also contained incentives to maintain cement production, which consequently drove exports from other EU countries into Great Britain.
23. The third phase of the Emissions Trading Scheme (ETS III) was due to start in 2013. Under ETS III each cement plant was allocated a number of emissions credits. A plant must use at least 51 per cent of its allocation per year to retain it for the following year. If a plant did not use 51 per cent of its allocation it would lose half its allocation the following year. This provided a large financial incentive to keep cement plants producing cement even when there was no ready market for the product.
24. In Tarmac's experience the rise in the import share of the Great Britain cement market had had an effect on the prices Tarmac charged as importers imposed a considerable price constraint. The quality of imported cement was the same as that of Great Britain-produced cement because all cement must meet EN197. Tarmac operated its cement plant at full capacity as it still needed its production for its RMX business, [REDACTED]. Tarmac's plant (Tunstead) was built in 2004, so it represented a very large capital investment and for it to operate efficiently it needed to run constantly.
25. Tarmac noted that its competitors had also responded to the economic downturn by focusing on their most efficient cement plants and closing or reducing production at their less efficient ones.
26. In Tarmac's view the cement market in Great Britain appeared to be competitive, and it did not believe that the other large cement producers were engaging in tacit coordination. Tarmac suggested that the increase in importers' share of the market at the expense of the domestic producers appeared to counter suggestions that coordination between large producers was occurring. Further, Tarmac noted that if there was tacit coordination, one would expect independent RMX suppliers to be under pressure, but instead their market shares were growing. Cement customers were able to switch suppliers when it suited them. Tarmac also argued that the Airtours criteria for tacit coordination were not met. In its view, there were asymmetries in the market, the degree of transparency required for coordination was not present, and the required punishment mechanisms did not exist. The price increase letters sent by Tarmac and other major cement producers to their customers did not allow the major producers to coordinate as the letters were merely an opening gambit in individual negotiations with customers. Tarmac did not know from its negotiations with its customers what its competitors' prices actually were, although it might know what other producers had initially proposed (as sometimes customers showed Tarmac other companies' pricing letters).

27. Tarmac's view was that return on capital employed (ROCE) was an appropriate way to assess the profitability of large cement producers as their businesses involved a large amount of capital investment. Tarmac used a number of financial measures to assess its performance, but simply assessing the level of margins (particularly variable cost margins) was not by itself an appropriate measure, because it did not reflect the overall return needed from the business.

Ready-mix concrete

28. Tarmac's RMX business was managed as part of its four regional divisions along with aggregates and asphalt. [X] Tarmac regarded its RMX business as very important as it provided an outlet for its aggregates and was therefore value enhancing for the total value chain. [X]
29. Tarmac suggested that the growth in the independent RMX sector could be attributed to a number of factors. These included the low cost of entry into the market. The costs of setting up a fixed RMX plant would be in the region of £150,000 for an independent, but they would be higher for Tarmac because of its adherence to its safety standards. Independent RMX businesses were able to change their cement and aggregates suppliers frequently in order to obtain the best prices they could, so they would often be paying less than Tarmac RMX plants for their raw materials. Independent RMX businesses also tended to run their own transport fleets which Tarmac considered might be cheaper for them than operating their fleets on a franchise basis as Tarmac did. Owners of RMX businesses were also often the businesses' commercial managers and were often able to build strong one-to-one relationships with their customers. As their businesses grew they could expand gradually into other geographic areas and through complementary businesses.
30. Tarmac was responding to the challenge from independent RMX businesses by [X]. An example of such a product was Tarmac's Topforce concrete, which did not require reinforcement as it had steel fibres mixed into to the concrete. [X]
31. Because RMX was produced by a batch process and because customers tended to require concrete at particular times during the day (eg the morning), RMX plants often operated at well below their theoretical production capacity. Currently, Tarmac's RMX plants were operating at around [X] per cent capacity on average, but even during periods of high demand they would only operate at around [X] per cent [X].
32. Tarmac's view was that the varied nature of local markets, the presence of a large number of independent RMX producers and volumetric truck operators and their proximity to customers meant that local RMX markets were not highly concentrated and larger players did not have market power at the local level.
33. Tarmac did not currently use volumetric trucks, but it did have one on trial as a pilot. [X] Volumetric trucks could now produce almost any grade or quality of concrete, and a truck could be purchased for between £100,000 and £150,000, so volumetric trucks provided a relatively inexpensive means of entry to the market. Tarmac had lost sizeable orders to volumetric truck operators in the recent past and regarded them as serious competitors.
34. Most of Tarmac's RMX orders were small in scale and received at relatively short notice. For larger projects, Tarmac could install a fixed plant on a site to supply a particular customer. While Tarmac received a large amount of repeat business from customers, since the economic downturn all its customers, even those with whom it had long-term relationships, had become more price-conscious and were more willing to change suppliers.

35. Tarmac calculated prices for RMX [REDACTED].
36. Tarmac's view was that the RMX markets were currently competitive and that the remedies for the Anglo/Lafarge JV might not therefore make much of a difference in the level of competition in these markets.