AGGREGATES, CEMENT AND READY-MIX CONCRETE MARKET INVESTIGATION

Summary of response hearing with Hanson held on 2 July 2013

Introduction

1. The Competition Commission (CC) confirmed that it would hold a separate hearing for Hanson to deal with matters relating to ground granulated blast furnace slag (GGBS).

2. Hanson stated that the markets had deteriorated in 2013 across all major product areas, and that the economic crisis continued, with market sizes in the UK having shrunk by some 35 per cent. In addition, [✂]. This therefore meant that there [✂]. Hanson therefore found it difficult to understand the CC's statements with regards to there being excess profitability in the business in such context.

3. Hanson stated that furthermore, the sale price of carbon credits had collapsed, falling from some €30 a tonne to only €2 a tonne, and therefore the economic dynamics of the market had shifted dramatically in this respect. [✂]

4. The change in the vertical integration structure of the market had also continued, with Hanson now having reached 100 per cent internal self-supply in cement.

5. Hanson stated that it was also seeing [✂], after competitive tenders had led to high levels of churn and switching.

6. Hanson had also observed a higher level of tendering in the market with the introduction of Hope Construction Materials (HCM); this had created greater competition and downward pressure on pricing. As a result of the creation of HCM and also Lafarge Tarmac there had been more tendering opportunities than previously, with customers wanting to multi-source after the Lafarge Tarmac merger, and HCM's pricing increasing the market tension.

7. Hanson felt that the creation of Hope had effectively introduced a new player into the market. In particular, Hanson observed that the plant was operating in a completely different manner to how it had under Tarmac management and was utilizing its excess capacity to sell to the market generally. Hanson believed that Hope should therefore be regarded as a significant competitor and one that had increased competition in the market.

8. In addition, there had been an increase in the import of cement into the UK. With the demise of Dudman, overseas cement manufacturers such as CRH had used this as an opportunity to create a stronger physical presence in the UK in the form of a national network of terminals. The expansion of CRH in the UK was representative of the trend towards overseas cement producers establishing a significant presence in the market. Paragon was also starting to sell surplus cement on the open market, which again was changing the market dynamic.

9. Hanson stated that CRH's strategy of acquiring facilities in the UK was very different from that adopted by others such as Titan. Hanson pointed out that unlike Titan, CRH had taken control of a number of terminals to create a national network around the British coast. It was a major cement manufacturer with facilities in Spain and Republic of Ireland, and so had access to its own supplies, unlike Dudman.

10. Hanson saw this acquisition of terminals by CRH as part of a long-term strategy designed to gain a network capability for it within the UK, as it had in other markets such as Belgium. Hanson thought that importers such as CRH might see the UK as an attractive outlet for their excess capacity overseas.

11. Hanson said that its GGBS business continued to come under pressure. Vertically integrated companies had surplus cement capacity and so had the option of using their own cement instead of GGBS. There were also other competitive constraints, such as Paragon importing GGBS and others such as Brett importing GGBS. GGBS had to be considered as a substitute for cement and its price was therefore closely linked to cement prices. Pulverized fuel ash (PFA) was also a cement substitute and the amount sold had been grossly underestimated by the CC.

12. Hanson stated its concerns that the CC's work on GGBS had only started at a very late stage of the investigation and lacked a suitable degree of assessment. It also stated that the European Commission had already approved the structure of the GGBS business at the time of HeidelbergCement's acquisition of Hanson Plc so expressed concern that the CC was now working to reconsider this.

13. Hanson contended that two of the tests which had produced the adverse effect on competition (AEC) finding were flawed in that they were based on expectations and were not found in any economic theory or empirical literature. When standard economic models were used, the observed patterns in market share and the alleged stability of margins were not consistent with coordination but were instead consistent with competition.

14. Hanson noted that a further key test employed by the CC was absolutely critical and related to profitability, which needed to show a sufficiently significant margin for a return on capital employed in excess of weighted average cost of capital (WACC) in order to prove an adverse outcome. Hanson's assessment revealed only a small margin in comparison to those seen in other inquiries, where higher margins were held by the CC as not excessive.

15. Hanson said that the CC should have included relevant impairment charges in its methodology when assessing profitability on a continuing cost of supply and financial capital maintenance basis. The CC's failure to deduct the relevant impairments from the earnings before interest and tax before calculating return on capital employed (ROCE) was another unacceptable omission and error on the part of the CC that rendered the CC's entire profitability assessment incorrect and unsafe. The inclusion of impairment charges would eliminate any small margins where ROCE exceeded WACC. There were also a number of other sensitivity testings that the CC had carried out which demonstrated that the returns could easily be reduced to below the WACC.

16. In terms of profitability, Hanson believed that the CC's assessment of competitors in the market was in fact consistent with a model of strong competition with only one firm earning in excess of the cost of capital and Hanson being one of the lowest.

Divestiture of cement plants

17. Hanson stated that divestment of [✂] would result in estimated impairment costs of at least £[✂] and that this cost was based on both the asset value and that attributed to the goodwill from Heidelberg after its acquisition.

18. Hanson [✂]. This would be even more the case should the market improve, and so Hanson would need to continue to make use of its capacity. In addition, should [✂]

be divested, Hanson would be unable to supply its customers. Hanson also emphasized that [✂] was an integral part of its logistics and overhead structure and therefore a key part of its portfolio.

19. Hanson did not believe that there was room in the market for a new competitor as it would impact the financial viability of existing players and so prove adverse. It did not think that a fifth Great Britain producer would have an effect on reducing pricing as there was already sufficient competition in the market (in particular, with the growing presence of importers such as CRH and Paragon). In addition, it thought that such a step could harm the economic viability of the other players. Any new player would have to price cement in a manner that was going to generate sufficient returns to cover the substantial fixed costs involved in running a cement plant. The subsequent volumes required to achieve this could potentially be severe for the viability of the established players in the market.

20. Hanson did not consider it necessary for any potential purchaser to own ready-mix concrete (RMX) plants alongside their cement plant and that this had already been demonstrated by various other players in the market. The CC's suggestion of divesting RMX plants along with a cement plant was counter-intuitive given its concerns about vertical integration. If the CC's reasoning was followed, the purchaser would be likely to focus on supplying themselves and this would have little to no effect on competition. In addition, should the purchaser wish to enter the RMX market, the barriers to entry were low. HeidelbergCement's own vertical integration approach had been designed to benefit its aggregates business.

21. With regards to latent capacity Hanson stated that, although it had a [✂]. Hanson anticipated that this could in principle take place [✂]. Without some form of latent capacity Hanson's ability to compete in the market and expand, would be significantly reduced.

22. Hanson pointed out that the lead time for activating mothballed plants depended on how long they had been out of service. The engineering requirements were particularly demanding for plants that had been mothballed for five or six years [✂]. This factor made it very difficult for Hanson to assess the latent capacity of its competitors.

23. It would be extremely difficult to comment on which plants might be suitable for a divestment option. There were numerous factors involved such as capacity, access to customers, rail-linkage, access to sufficient reserves and associated planning permission. The specific criteria would depend on the strategy of the investor. London and the South-East was the most important market and therefore a new player would need to be able to access that market.

24. There were a range of possible companies that could conceivably be interested in purchasing a cement plant, for example CRH, AI/HOLCIM, a steel company or a private equity company. However, Hanson questioned whether these companies would still remain interested after carrying out due diligence and considering the level of interest from competition regulators in this market. Hanson stated that the CC's market investigation itself had already damaged the prospect of foreign investment in the Great Britain cement industry.

Divestiture of RMX plants

25. It was explained to Hanson that the intention of this proposed remedy was to divest RMX in order to reduce the level of cross sales between majors.

26. Hanson did not believe that the divestiture of a RMX plant could be effective to increase the size of the addressable market, since it was already vast and represented the bulk of the entire market. The size of the existing addressable market was sufficiently large. Adding additional volume would have only a marginal effect at best.

27. Hanson stated that due to the large accessible market that already existed, any new RMX competitor would simply be viewed as another customer and would not affect the dynamics of the customer base.

28. Hanson believed that any RMX plants that were divested from an existing, vertically integrated competitor would most likely be purchased by other established RMX players. Due to the nature of the tendering process it would therefore be unlikely to have any material effect on the price of cement.

29. Hanson noted that, were it forced to divest RMX plants, it could result in Hanson having to close or mothball a number of its aggregate sites as it would lose the benefit of selling aggregate into RMX. This was due to the stability and structure provided by the vertical integration of aggregates into concrete and it would have the effect of adversely impacting the strong competition that Hanson considered currently existed in local aggregates markets.

30. Hanson thought that, should Hanson and Cemex be forced to divest a number of RMX plants, it would then leave Hope in a clear market leadership position, even if Hope did not buy any of the divested assets. Were such an undisputed leader to emerge, it could potentially threaten the competitiveness that existed in the RMX market as it would change the market dynamics to one dominated by a leader, with the potential for exactly the same imbalance and issues as the CC had voiced concerns about with regard to cement.

Hanson offer of a mandatory tender process in the event of the need for future cement purchases by majors

31. The voluntary remedy proposed by Hanson with regard to mandatory tenders for hypothetical future cement purchases would be effective to address all of the CC's stated concerns with regard to the historic cross sales seen in the industry.

Creation of a cement buying group or groups

32. Hanson believed that cement buying groups (CBGs) could attain a level of purchasing power and that as evidence of this, buying groups already existed and were effective in the packed cement business. Although, with regards to RMX, there might be a number of potential perceived complications. These largely revolved around purchasers' need for a variety of materials (which could sometimes be quite specific and dependent on the nature of the job) and the location and structure of their silo capacity. RMX independent competitors might also choose on an individual basis to not want to cooperate with each other in order to form a buying group, particularly when they were already competing fiercely locally in order to win business and to seek to differentiate themselves rather than all obtaining the same prices. Whereas packed cement was a final product similar to a commodity, bulk cement was a raw material, an input into a final product, and this created some additional complications.

33. Hanson had not given much consideration to the future use of a spot price for cement, which would provide customers with a benchmark for negotiations. However, this depended on the requirements of the individual customers which could often be

highly specialized. Different purchasers within the group might have different requirements.

34. Hanson also noted that the creation of CBGs could result in Hanson being able to supply groups that contained purchasers which Hanson otherwise did not consider creditworthy.

35. Hanson stated that buyer groups had the advantage of being able to pool credit and structure better guarantee arrangements with banks. This in turn could give lead to more favourable pricing where this might otherwise be adversely impacted by worse credit risk for an individual customer.

Prohibition on Great Britain cement producers sending generalized cement price announcement letters to their customers

36. In principle, Hanson did not foresee any problems in individualizing its price announcement letters as it viewed them merely as a starting point for negotiations with the customer. Price letters were beneficial for its customers as they allowed them to plan ahead in terms of how much product they required and what their cost base would be, and it started price negotiations. Hanson did not see how trade could be effected without notifying customers of its prices.

37. Hanson believed that there were already obstacles to any transparency in the headline price included in such letters, as the eventual price was often very substantially different. Individualizing letters could, however, help hypothetically to counter the concerns the CC had with regard to transparency in prices.

38. Any solution put in place for cement, such as personalized price letters, would probably influence the cement substitutes market as well due to products such as GGBS being intrinsically linked to cement. Therefore Hanson did not see the need for such measures with regards to the substitute market, although it did not have any objections to doing so.

Restriction of MPA and BIS data

39. Hanson believed that restricting the release of Mineral Products Association (MPA) data for three months would not unduly affect its planning. Although Hanson currently received MPA data on a monthly basis, it was looking for long-term trends in the data to see how the market was evolving so it could plan its budget and production efficiently, and it saw nothing of value in single month data and indeed it was not reliable.

40. Hanson felt that if the data was delayed for up to six months it would be damaging to industry's ability to allow efficient business and production planning. Hanson had never used the current format of data on a monthly basis for any form of knee-jerk reaction, since that single month data could not be relied upon and had never been used by Hanson for such objectives.

41. The market data formed an essential part of Hanson's long-term strategic efficiency and production planning and enabled it to gauge whether the market was contracting or whether it was the case that its share was down in any given economic climate. Without such data, Hanson said industry would be damaged since it would lose the ability to plan production efficiently.

42. Hanson was concerned that restricting regional coverage of MPA data would prevent it from making informed decisions regarding the logistics of its regional operations. This would not affect products such as cement which was assessed on a national level. Senior management had not realized that such regional cement data was available, until the CC had informed Hanson of its existence.

43. With regards to EU Emissions Trading System data, Hanson stated that such information was only of use to it in terms of determining what its carbon allocations would be for carbon credits. It did not use the data to analyse the market. It did make the information available externally in the form of sustainability reports and external statements as various stakeholders were interested in Hanson's compliance.

Structural measures to address the AEC in relation to GGBS/GBS production in Great Britain

44. Hanson had paid in excess of £200 million for the historic investment into GGBS, that reflected Civil and Marine's investments and the duration of the contracts and the exclusivity. It noted the complete uncertainty and the lack of any stability in steel production and the consequent [✂] supply of GBS. Therefore the exclusivity was critical to be able to secure supply from multiple locations because of the unreliability or lack of guarantee of that supply of GGBS from the steel industry. These arrangements had been approved by the European Commission under the EU merger regulation, and there had been no change in circumstances since the acquisition was approved.

45. There was still a need for exclusivity due to the very uncertain future of the steel industry: customers needed security of supply to know that if one plant was no longer operating then it could still purchase GGBS to discount its cement.

46. [✂]

47. Tata also took comfort in the exclusive nature of the contracts between itself, Lafarge Tarmac and Hanson, giving it assurance that its waste product would be removed from sites and used.

48. There was an intricate link between where GBS and GGBS were produced and therefore there was a difficulty in separating the logistical relationship between the steel producer, the GBS producer and the GGBS producer.

49. The CC should not underestimate the role of PFA as a competitor in the cementitious products market. This, with limestone filler, represented a similar-sized market to that of GGBS and therefore it offered a meaningful alternative way to entering the cement substitutes sector other than through GGBS or importing GGBS.

50. Hanson pointed out that a further complication in terms of divestment would be the number of parties involved [✂]. In addition, it would require significant due diligence on the part of a potential investor, and the biggest issue for any buyer would be [✂]. These aspects would add considerably to the period of negotiation required of such a divestment process.

Other possible cement remedies and relevant customer benefits

51. Hanson believed that although hypothetically it might be easier physically to divest a stand-alone clinker grinding plant, such a plant would need to be externally supplied

with clinker from overseas and that the purchaser would therefore more than likely be an established cement producer rather than an independent.