

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

Summary of hearing held with Tarmac on 12 December 2012

Introductory comments and general questions

1. Tarmac had experienced significant financial difficulties due to the recession which had impacted on its performance.
2. Demand for Tarmac's products had declined by 30 per cent to 40 per cent since 2007 and the future remained bleak, with further significant decline forecast. This was coupled with higher input costs, including fuel and energy. Tarmac had undertaken a rigorous programme of cost reduction but it was increasingly difficult to find further savings.
3. Tarmac faced significant difficulties in securing work at adequate margins. Profitability remained low, with the company recording a nearly breakeven earnings before interest and tax margin in 2011.
4. Tarmac felt that analysis by the CC overstated the level of Tarmac's product margins. Tarmac held that this was due to the multi-product nature of its organizational structure and [redacted].
5. With regard to coordination in the cement market, Tarmac wished to emphasize that its focus had been on self-supply with limited external sales. For this reason, it had seen itself as distinct from the other major cement suppliers. Nonetheless, it did not recognize the features of coordination in cement suggested by the CC.
6. Despite increased competition from cement importers, Tarmac had been able to maintain sales [redacted]. Tarmac believed that these importers were not always seeking to sell cement above production cost but instead were protecting their EU carbon credit subsidies.
7. Both Tarmac's vertical integration (VI) and scale offered it efficiencies and allowed it to manage the supply chain. There were lots of other models of VI in the construction materials industry (not just VI from cement and aggregates into RMX), and non-VI businesses could also grow.
8. Tarmac felt that the CC's updated issues statement had underestimated the extent to which the Emissions Trading Scheme drove cement suppliers and affected competitors' behaviours and actions.

Aggregates

9. According to Tarmac, the main recent change to aggregates planning policy was the increased role for local authorities in planning for aggregates demand in their areas, rather than national and regional demand being apportioned to local areas. A new guidance note from Department for Communities and Local Government on aggregates planning policy, issued in October 2012, indicated that local authorities should give increased preference to recycled and secondary aggregates when planning for future aggregates supply.

10. Tarmac was broadly comfortable with the aggregate market definitions but noted that the CC did not take into account the growth in recycled and secondary aggregates. Tarmac made reference to the CC's inferences that it did not wholly recognize asphalt road planings as a recycled product. Tarmac disagreed with this, referring to how companies had begun to recognize the intrinsic value of bitumen within the product and that they had always been used as a sub-base or construction fill product. Rising oil prices had incentivized Tarmac to increase its substitution of bitumen.
11. Tarmac felt it should be noted that in terms of concrete products some regions had used recycled and secondary sources for up to a quarter of their aggregate requirement.
12. Tarmac confirmed that, although only a small feature of its aggregates business, cross-sales arrangements with other Majors did exist. Such arrangements were typically driven either by logistical efficiencies or negotiated as part of a strategic divestment or acquisition. Medium- to long-term agreements were not unusual to ensure security of aggregates supply into downstream operations. Tarmac confirmed that prices in such arrangements were arm's length and were often subject to indexation or periodic open market review.
13. Tarmac's policy was to [REDACTED]. Nevertheless, it was not Tarmac's explicit policy to set internal aggregates prices higher than external prices; any such divergence was a consequence of the relative realization of requested price increases.
14. [REDACTED]
15. [REDACTED] Tarmac commented that price increases were aspirational and represented nothing more than the starting point for bilateral price negotiations. Price requests were rarely achieved, with actual out-turn price movements very widely dispersed and occasionally negative, if market conditions so dictated.
16. When comparing average internal prices and external prices, [REDACTED].
17. Tarmac had some historical awareness that other Majors might have also pursued similar policies as regarded internal aggregates pricing. However, it was very difficult to assess due to the substantial changes in the market over the last few years, and Tarmac had no detailed knowledge of other Majors' current practices.
18. Tarmac's internal transfer pricing policy for aggregates did not affect competition in the RMX market, as RMX pricing was [REDACTED]. However, Tarmac's internal pricing policy did [REDACTED].
19. Tarmac's internal pricing for cement differed from its approach to aggregates, in that Tarmac made fewer external sales of cement, [REDACTED].
20. Tarmac's internal aggregates prices were [REDACTED].

Profitability

21. Cost reductions (including increased use of alternative kiln fuels) and CO₂ credits [REDACTED]. Tarmac [REDACTED] cement output [REDACTED] produce at full capacity, which enabled it to reduce its per-tonne costs of production. This year, it was [REDACTED] at its single cement plant.
22. It cost an estimated £[REDACTED] to fire up a kiln, so it was expensive to run it on a stop-start basis, ie at less than full capacity.

23. Tarmac's external prices for cement [REDACTED]. Sometimes it was more profitable to sell such cement externally and source cement locally from other cement producers for these RMX plants. Tarmac confirmed that given the high costs of haulage, where logistical efficiencies could be mutually achieved, swap arrangements were in place with other cement majors.
24. Tarmac's experience was that external cement prices in real terms had gone down. It believed that this was largely due to an increasing amount of competition from importers and other majors. The fact that [REDACTED].
25. Tarmac's first kiln at Tunstead cost Tarmac £[REDACTED] million in 2004. It was commissioned as a 'turnkey' project. As the cost to the contractor was believed to be approximately £[REDACTED]. When Tarmac investigated the possibility of building a second kiln at Tunstead in 2009, the cost of this second kiln was estimated to be £[REDACTED] million (with the increase in costs from 2004 being a result primarily of the increase in the cost of steel and other base metal commodity costs during this period).
26. The main reason that Tarmac was the lowest-cost Great Britain cement producer was that it was the cheapest, newest and worked to full capacity. It was leading edge in the use of alternative fuels, and it had the most modern plant (other operators had more breakdowns and therefore more repair and maintenance costs). It also made the most of its rail links. It had invested in its rail depots at the same time as it had the new greater-capacity plant built and built its distribution infrastructure around the new plant. These depots were in Leeds, Walsall and London. However, unlike Lafarge, it did not have blending facilities at these depots.
27. Tarmac did not use cement market share as a management tool. Instead, performance was generally measured and dependent on capacity utilization and the level of efficiency and production costs. Market share could have an impact on investment decisions such as an extra plant and Tarmac was aware of the market share that it had and could benchmark its performance against its market share movement, but it was not aware of what other competitors' shares were as information was aggregated. Tarmac did not look at market share as a key metric for decision-making.
28. Tarmac acknowledged that its own market share could be derived from publicly available information and could be tracked. The emissions trading requirements for reporting metrics such as capacity meant that Tarmac could estimate the level of capacity utilization that competitors' plants had been operating at, albeit this was limited information.

Cement

29. Tarmac's strategy was to be a price follower. It therefore tended to announce its price increases last. Tarmac's commercial strategy was to sell externally where it felt it could make a better margin than if selling internally, and therefore took into account its competitors' price announcements, although did not know how successful these might have been. This either came through trading with other majors or when customers showed Tarmac what competitors had published. Tarmac noted that price increases were aspirational and represented a starting point only to bilateral negotiations, with price outcomes demonstrating a wide dispersion.
30. Tarmac [REDACTED] when determining requested price increases. Any price increase for cement was determined largely by [REDACTED].
31. Tarmac's price increase announcements took into account [REDACTED].

32. Despite being a price follower and releasing its price announcements relatively late, Tarmac's customers did not seem to find this a difficulty. The amount of notice they required generally depended on what the individual customer was producing and what its financial situation was.
33. [REDACTED]
34. Tarmac always balanced [REDACTED].
35. Tarmac had concerns about the methodology the CC used in the price parallelism. There were too few data points, the CC had been selective about what costs had been included, and the analysis should have been done on a production basis rather than a sales basis (as, for example, plant shutdowns would increase costs and affect production, but would not map across clearly to sales).
36. The fact that Tarmac made [REDACTED].
37. Tarmac noted that, in response to the Hanson internalization, Lafarge may have chosen to close capacity, rather than 'creating some kind of price war'. Tarmac noted that the Hanson internalization also fortuitously coincided with the exhaustion of reserves at some of Lafarge's cement plants.
38. Tarmac said that, while there was significant overcapacity in cement in the UK, there was no incentive to export this overseas (as some foreign suppliers had done). Tarmac believed this was likely to be due to UK suppliers being able to achieve their benchmark capacity and therefore get European carbon credits.
39. The Republic of Ireland had something like 7 million tonnes per year of capacity but domestic demand was now only around 2 million tonnes of capacity, meaning that there was a great deal of surplus capacity there. The fact that the Republic of Ireland therefore had 5 million tonnes of surplus, combined with the incentive of carbon credits, highlighted the incentive for increasing levels of cement being imported.

Overall coordination question

40. Tarmac did not see any evidence of coordination in the cement market, either explicitly or tacitly. It felt that the true measure of coordination was profitability, and the fact that it was struggling to make a profit, and sufficient return against its cost of capital, argued against the presence of such coordination. It would also expect prices to be higher if there was coordination.

GGBS

41. [REDACTED]
42. [REDACTED]
43. [REDACTED]
44. Tarmac exported a small quantity of GBS to the Republic of Ireland [REDACTED].

JV remedies

45. The main change in the cement market as a result of the JV remedies would be that all four Great Britain producers would be 'long' in cement, rather than three 'long' and one 'short'.
46. Tarmac said that, as a result of the JV, it would be a more balanced business. It would have more cement but a lot less concrete than it might have hoped.
47. As a general statement on the construction materials industry, Tarmac felt that the biggest impact would be on British manufacturing employment and that this would be largely due to increased importation.
48. Tarmac believed that Mittal Investments had acquired a strong business at a period when it was a buyers' market and that [✂].
49. Tarmac considered that the JV, and the divestment remedies, would result in a radical change to the market structure during the course of the market investigation, and that this would present particular challenges to the CC.