

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

Summary of hearing held with Aggregate Industries on 10 December 2012

Introductory comments and general questions

1. Aggregate Industries (AI) said that the market outlook was poor. Construction output in the UK was the lowest it had been in ten years. The downturn had had a significant impact upon the aggregate and ready-mix concrete (RMX) markets. AI said that it was not surprised at the CC's view that aggregates producers were making low returns on capital. [✂]
2. AI broadly agreed with the preliminary views set out in the updated issues statement in relation to aggregates and RMX. AI was not a cement producer in the UK. It imported and purchased cement, primarily for internal use. It noted that the CC's analysis indicated that 90 per cent of aggregates job sites had a choice of five or more suppliers. The market had declined by 25 per cent in the last five years and suppliers were competing hard for the remaining demand, as shown by the CC's case studies and profit analysis. It was not surprised that the CC's analysis appeared to suggest that having additional suppliers in a location did not affect prices as competition was already strong in all locations irrespective of the number of suppliers. AI strongly believed that vertical integration had benefited customers.
3. AI was adjusting to a 'new low' in construction activity. It was lobbying government to make much-needed investments, eg in roads, but projects were some way off. In 2013, output in the construction sector was forecast to be between 4 and 5 per cent lower than in 2012.
4. AI said that customers valued the benefits from vertical integration. Customers wanted a broad range of products and services—customers were looking to AI to give them a 'total solution' across the whole supply chain. AI considered that its success in winning work for the London Olympics demonstrated the value customers placed on the solutions AI was able to offer. [✂]
5. [✂]
6. In relation to planning and regulation, AI said that the Carbon Reduction Commitment applied to AI but it was not a producer of cement and so was unable to participate in the EU Emissions Trading Scheme (ETS). This resulted in a significant charge for AI. Any issues around planning for new aggregates production were fairly academic in the current economic climate. All suppliers had access to planning consultants and a level playing field existed. The new planning regime should make things more straightforward. And Mineral Products Association data suggested that large and small players had pretty much the same success rate with their planning applications.

Aggregates

7. AI broadly agreed with the CC's Market Definition working paper. However, it considered that sand and gravel were substitutes for crushed rock (eg in asphalt production, and also in general construction applications especially in areas where crushed rock was less available). AI also considered that the CC had under-represented the importance of secondary and recycled aggregates which were

directly substitutable for primary aggregates in RMX, concrete block and asphalt production, as demonstrated by AI's own behaviour (eg it had substituted china clay for primary aggregates in its London RMX production). In addition, the sustainability agenda was driving substitution of primary aggregates.

8. AI said that probably, on balance, it was more straightforward to expand an existing quarry rather than open a new quarry. In many respects (eg duration of the planning process), however, applications to expand a site were very similar to greenfield applications
9. [REDACTED]
10. Customers with large construction schemes would tend to get better pricing than customers with smaller schemes given the economies of scale. Larger customers were very skilled at negotiating price and were aware of the industry's spare capacity. They also drove hard on non-price factors (eg environmental factors). Buyer practices varied by contractor. Some were very centralized whilst others made purchasing decisions on a much more decentralized basis. At the top end of the market, for large infrastructure projects, projects were getting more sophisticated. However, AI positioned itself as being able to offer services to all its customers, from very large projects to one-off jobs (eg a farmer who needed aggregates laid down for a track). For large infrastructure projects (eg Hinkley Point) clients wanted visibility across the whole supply chain. These customers were very skilled at procuring materials and were able to install on-site their own RMX plants.
11. AI operated in local markets where it competed against independent as well as major producers. It was more relevant to look at fascia. Some independent producers were, regionally, large players who were also vertically integrated [REDACTED].
12. There was a large choice of supplier and considerable excess capacity in the market, resulting in strong competition. This might explain why the number of competitors (and/or the presence of independent/recycled aggregates producers) appeared to have little effect on price according to the CC's price-concentration analysis. The PCA might not have captured fully the constraint from recycled producers who tended to 'come and go' and might not show up in the data. The presence of a recycled aggregates producer could have a significant, short-lived impact on the local market. AI was not a demolition contractor, but it bought some recycled aggregates for sale on to third party customers.
13. AI sold some aggregates to other Majors but was a net purchaser of aggregates from other producers. It bought twice the volume of aggregates from independents than it bought from the other Majors. [REDACTED]
14. AI had seen very large increases in its input costs [REDACTED]. Its price increase announcement letters [REDACTED].

Profitability

15. AI said that the CC had assessed profitability on a consolidated basis which distorted the true picture. The CC needed to assess profitability on a quarry-by-quarry basis and allocate revenues from inter-depot internal transfers to the business. [REDACTED]
16. AI's policy was that the internal transfer price should be the market price (for the same products). [REDACTED]

17. Whilst it was difficult for AI to comment on profitability in the cement market as it did not produce cement in the UK, high apparent returns might be the result of cement being a highly capital-intensive industry, with the size of the market (currently, about 8Mt) not attractive enough, either through setting up new cement plants in the UK or through importing cement on a large scale. The size of the market opportunity probably explained why there were not more imports.
18. AI [redacted]. The market was weak and independents had sought opportunities to expand (eg the entry into the market of volumetric trucks and the use of recycled aggregates). AI had sought to grow its value-added product (VAP) range and value added services (VAS) [redacted]. Its revenues per tonne of concrete appeared to be higher—based on publicly-available information—than its rivals because of this focus on VAP/VAS. [redacted]

Cement

19. AI agreed with the conclusions in the CC's Market Definition working paper in relation to cement.
20. [redacted] AI [redacted] had an import option (ie from Holcim in Germany). However, importing carried risks around the security of supply, exposure to foreign exchange fluctuations and exposure to shipping/freight costs.
21. [redacted] It compared the price on offer from the Great Britain producers against the Holcim 'international cement price' allowing for the cost of delivery to the UK and onward delivery to AI's RMX plants (ie a 'delivered' price). It would compare, as part of its annual budgeting process (beginning in the autumn for the coming year), the price of importing cement against what it needed to source from UK cement producers. [redacted]
22. [redacted]
23. [redacted]
24. [redacted]
25. [redacted]
26. [redacted]
27. AI [used] pulverized fuel ash (PFA) [redacted]. For its ground granulated blast-furnace slag (GGBS) requirements (for certain specifications, and in certain parts of the country where PFA was uneconomical), AI [redacted] import [redacted] GGBS [redacted].

RMX

28. Barriers to entry in RMX were low. Independent RMX producers were able to compete for [redacted] AI's RMX sales. For large jobs, RMX suppliers would need to be able to demonstrate that there was a back-up supply. On larger jobs, backward integration from contractors using on-site RMX plants was possible. AI would only refuse to supply an RMX customer for credit risk reasons.

Vertical integration

29. The fundamental issue deterring entry into cement production in Great Britain was the size of the market, not vertical integration (VI) per se. AI's VI between aggregates and RMX was driven by the ability VI gave to offer full value-added solutions to customers. [✂] VI between aggregates and RMX also balanced the risk between public and private sector expenditure. Public expenditure drove demand for aggregates. Private expenditure (eg house building) drove the demand for RMX.

Impact of the entry of Mittal

30. AI said that, given the market structure in the UK and number of competitors already present, the entry of Mittal was unlikely to have much impact.