COMPETITION COMMISSION

ANGLO AMERICAN/LAFARGE MERGER INQUIRY

Summary of hearing with CEMEX held on 12 October 2011

Background

1. CEMEX entered the UK market in 2005 through its acquisition of RMC. RMC was a well-established business in the UK, so the difficulties CEMEX faced at the time were associated with integration, rather than market entry. Prior to the acquisition of RMC, the only real presence CEMEX had in Europe was Spain.

2. CEMEX noted that in the last few years, the industry as a whole had experienced a decline in turnover and profitability. Given the uncertainty about public spending, major infrastructure projects and the effect of the proposed planning reforms, this was unlikely to improve.

3. One regulatory issue affecting the industry was the proposed changes to the planning system as it was unclear what effect they would have on construction (particularly house-building). Another issue was the upcoming implementation of phase three of the EU emissions trading scheme, which would reduce the amount of carbon allocated to companies like CEMEX. As the construction materials industry, particularly cement, was quite carbon intensive, this, along with the Government's commitments to reduce carbon dioxide emissions, would increase costs.

4. A big question for the industry was the effect of the current European economic crisis and the speed at which public infrastructure spending would be resumed. This would determine the speed at which the private sector would recover. There were also uncertainties about the cost of energy and fossil fuels, which were used in bitumen for asphalt applications.

Market definition and competition

5. CEMEX supplied aggregates, ready-mix concrete (RMX), asphalt and cement, along with building products such as roof tiles, concrete blocks and railway sleepers. Apart from high purity limestone, it supplied a full range of aggregates.

6. With the exception of some applications, there was now a high degree of substitutability between secondary, recycled and primary aggregates. Processed and recycled materials could now make high quality concrete and there were recycled materials that could be used for the skid resistant top layer in asphalt. The main issue with recycled aggregates was availability as they were mostly available only in urbanized areas (although this was where most of the demand was anyway). Secondary aggregates were slightly different in being only available in certain markets (eg slate, which was mainly available in Wales) and they tended to be used for fill materials, although could be reprocessed further and be used for more premium applications.

7. CEMEX supplied recycled aggregates, which it acquired from demolition contractors and construction contractors. These contractors brought their materials to CEMEX's landfill sites and CEMEX then recycled and reprocessed the materials, such as by crushing and adding the materials to asphalt in its asphalt plants.

8. Merchant hauliers also provided a strong competitive constraint in relation to aggregates, as they bought all types of aggregates from all the majors and the

independents and sold them on, gaining a competitive advantage from more efficient use of their trucks (such as by using them to take muck away from sites to which they had delivered).

9. Mobile asphalt plants could be used as an alternative to having asphalt delivered. To set up a mobile asphalt plant, the customer needed to have the capital (around £750,000 to £1million for a second-hand one), a large enough site and planning permission. Mobile asphalt plants were suitable for large jobs such as airports and motorway contracts. Mobile plants tended to be operated by contractors, rather than suppliers. CEMEX did not operate any mobile asphalt plants itself.

10. A number of its asphalt plants were able to operate 24 hours a day, seven days a week; however, it had been told it was able to apply to the relevant local authority for permission to run any plant 24/7 if a specific contract required it. The only price difference would be to cover any extra costs (such as staff overtime and night-time haulage).

11. On the subject of blended cements, CEM1 was otherwise known as ordinary portland cement, while CEM2 and CEM3 were made by blending CEM1 with increasing proportions of Pulverised Fuel Ash (PFA) (in the case of CEM2) and Ground Granulated Blast-furnace Slag (GGBS) (in the case of CEM3). Blended cements took slightly longer to hydrate, but not to a noticeable extent. They also achieved comparable strengths to CEM 1, but developed it at a slightly slower rate. PFA was a cementitious material and standards allowed up to 35 per cent replacement of cement with PFA, but GGBS had higher cementitious properties and consequently larger quantities could be used to replace cement.

12. CEMEX supplied CEM 1 and CEM 2, but not CEM 3, although its RMX division purchased GGBS to blend onsite to make concrete. Hanson was the only source of UK-produced GGBS, but it was not the only source of GGBS, as it was also imported. There were more domestic sources of cementitious PFA, although these had reduced in the last ten years as coal-fired power generation had declined. Also, the coals that the generators used affected the quality of the ash. Nevertheless, there were substantial quantities of PFA on the continent that could be imported.

13. Volumetric trucks (whereby the raw materials for the concrete were carried on the back of a lorry and mixed onsite, as opposed to RMX which was pre-mixed at the concrete plant) were very competitive in terms of the quality and service they offered. Volumetric trucks could produce concrete of equal quality and strength as RMX and was increasing its share of the market having been available in the UK for the last ten years. Although in principle volumetric trucks could supply large-pour-style projects, they generally had not been used because of the need to have a large number of vehicles.

14. The cost of entry into the market with a volumetric truck was very low and there was a diverse range of operators, from contractors to independent entrepreneurs. CEMEX itself did not operate any volumetric trucks.

15. The extent to which RMX site plants competed with fixed plants depended on the application. Typically, an RMX site plant would be put in place for a project that required a dedicated supply of concrete enabling the contractor to obtain concrete whenever it was needed (eg a large infrastructure project) and tended to be used either because of the size of the project or geographical constraints (ie the site not being near a local network of supply). Site plants were not only put up by the major construction material suppliers, but also by contractors. There were also operators of

small Benford mixers, which could be classed as onsite plants for mixing concrete for driveways and small buildings, etc. CEMEX had site plants that it set up as required.

16. It was economic to supply aggregates and asphalt up to a distance of 30 miles and RMX up to about 15 miles.

17. Cement was a national market so it did not consider that it competed with Lafarge more in one region than another. However, it was more competitive closer to its facilities because distribution was a significant cost with cement.

18. Competition for aggregates, RMX and asphalt centred on the location of the plant and these products therefore competed in a series of local markets. Competitors would therefore depend on who was operating in the relevant area.

19. As well as producing those materials, CEMEX also purchased them where they were to be used in areas which were a significant distance from its own production facilities but closer to those facilities of its competitors.

20. Although it had some cement import terminals, it had not imported cement for four years and used them as depots for UK-sourced cement. Cement was also transported within the UK by sea. For example, cement produced in Lincolnshire was transported by ship to a terminal in Scotland from where it was distributed to the Scottish market. This was because it was cheaper than transporting by road.

21. Sales of its bagged cement were done predominantly through contracts and, by contrast, bulk cement was sold on a spot basis with no exclusivity of supply. Aggregates were also sold mainly on a spot basis. Asphalt was generally supplied on a contract basis, as was RMX.

22. RMX, aggregates and cement customers were able to negotiate over prices and the overall environment was very commercial. Customers might talk about better prices from a competitor, but very rarely would CEMEX have any indication of what that price might be and negotiations came down to the price the customer was seeking against the price at which CEMEX was prepared accept.

23. CEMEX was not aware of any instances where it might have refused to quote for cement sales to a potential customer although there were of course occasions where customers were quoted prices that they did not find attractive.

24. It had separate commercial divisions for the sale of cement, aggregates, asphalt and RMX respectively. There would be large projects for which it supplied several products, such as concrete and aggregates. CEMEX did not know if any of its competitors bundled these products, but had not come across the practice.

25. With regards to pricing transparency, cement was a high-fixed-cost business, which meant that CEMEX would have an idea of its competitors' cost structures based on its own. However, this would be no more than an estimate given the different technology options for manufacturing cement (eg kiln technology, types of fuel) which would affect the actual costs involved. It was similarly not possible to know the prices charged by its competitors because of the vast number of different prices paid by customers.

CEMEX as a customer

26. When purchasing aggregates and cement for RMX it sought quotations from all suppliers, not just the majors but independents as well, as long as they met its

requirements in terms of quality. CEMEX had never had any difficulty obtaining the products it needed in the quantities it required. There had been enough capacity in the market over the last five years, with the exception of 2007, when CEMEX and Lafarge experienced technical problems simultaneously.

Barriers to entry/expansion

27. A new entrant would find building a new cement plant cost-prohibitive given the current economic climate. Market demand would have to increase significantly before it could be financially justified.

28. Barriers to enter the RMX market were very low and volumetric and fixed-plant entrants to the market were common, many of which were independents. It was easy to set up a volumetric business, as evidenced by the growth in that sector over the last few years. There were also plenty of options regarding supply of raw materials. With respect to entering the asphalt market, the only issue was the high capital cost of setting up an asphalt plant, which could be in the region of £3 million for a fixed plant. Because bitumen and fuel costs were so high at the moment and the margins on asphalt were so low, the barrier to entry was one of economic feasibility.

29. Barriers to entry for cement were high as manufacturing cement was very capital-intensive, required reserves of raw materials and was a highly regulated industry. By contrast, the barriers to becoming an importer of cement were reasonably low and CEMEX had seen import facilities open up in the last six months (eg Dudman opened an import terminal in Liverpool and was close to opening one in Montrose, Scotland). Imported cement faced lesser regulatory controls than UK-manufactured cement—UK manufacturers must pay for carbon emissions whereas manufacturers from outside the EU did not have to pay similar costs. CEMEX saw imported cement as a credible alternative to cement manufactured in the UK and of comparable quality, being sourced from credible manufacturers abroad and required to meet UK standards. Continuity of supply depended on how much storage capacity was available at the import facility, but most importers had large silos.

30. An alternative to a full cement plant was to set up a clinker grinding plant, which would purchase rather than make its own clinker, the most energy intensive part of making cement. While this reduced the costs involved, it did require finding a source of clinker that could be sourced from abroad if not the UK, for example (CEMEX operated its own grinding plant at Tilbury).

31. With aggregates, there was sufficient competition and availability with respect to domestic UK supplies such that imported aggregates tended to be premium, higher-end specification specifically for use in high PSV asphalt. However, while aggregates could be sourced from quarries at various places around the country and there were also ready sources of secondary and recycled aggregates, getting planning permission for a new quarry was a significant barrier to entry. Under the managed aggregate supply scheme, if there were sufficient permitted reserves or consented reserves in a particular region to meet forecasted demand, obtaining further consent for an extension or a new quarry was highly unlikely.

The counterfactual

32. There would be no effect on Tarmac, Lafarge and the industry in general if the joint venture never happened. CEMEX was aware that Anglo American was looking to divest its Tarmac operation, so if the joint venture did not go ahead, Tarmac might be broken up.

Concerns about the joint venture

33. The transaction might have particular significance in the Midlands as Lafarge and Tarmac had many quarries there. Nevertheless, because there was so much aggregate available in the area and there were so many substitutes, CEMEX did not think the joint venture would have any detrimental effect.