AGGREGATES, CEMENT AND READY-MIX CONCRETE MARKET INVESTIGATION

Summary of hearing with Breedon Aggregates held on 26 September 2012

Background

1. Breedon Aggregates (Breedon) told us that the construction materials market was currently very difficult. The recession had caused a massive reduction in demand, which had begun in the last quarter of 2008, had continued through 2009 and had finally plateaued at the end of 2009 and the start of 2010. Most products had seen reductions in volume of 30 to 40 percent, which was unprecedented. There had been a gradual decline in the UK aggregates market in the years before the downturn, which had been caused by a number of factors including the reduced building of infrastructure and the increased use of recycled materials. At present there was significant overcapacity in the market, and Breedon did not foresee a significant recovery occurring in the next few years.

2. Breedon's plans for the future were based on the state of the market remaining much as it currently was, with the possibility of a gradual recovery if some of the infrastructure projects proposed by the Government were started, but these often had long lead times and might not begin for some time due to planning and funding issues.

3. There was fierce competition for the remaining available work. Rather than competing for the largest projects (eg resurfacing motorways) which were often targeted by the majors, in England Breedon had decided to focus its efforts on supplying smaller projects, such as small housing estates, and working with customers it already had good relationships with and who had a lower credit risk.

4. Breedon considered that the returns currently made by participants in the construction materials industry were not sustainable in the long term because of the industry's capital-intensive nature which required continuous reinvestment in plant. Current returns might not be great enough to support that reinvestment. As there were currently fewer large projects, the majors had started competing for smaller ones. Breedon had lost work to competition from majors in its core market in the East Midlands.

5. Despite the current market situation, Breedon had been able to deliver reasonable results. It had managed to reduce its costs which, along with careful work selection, had allowed it to increase its margins. Over the medium to long term Breedon believed that the market would recover, and this was the view it took for its business and further investments it planned to make, including any acquisitions arising from the Anglo/Lafarge JV remedies that it might be able to make.

6. Although sizeable, Breedon still operated a business model where it had close communication with its customers, and it felt that this gave it an advantage over the majors, which Breedon considered were more remote from their customers.

7. Breedon considered that a 10 per cent increase in volumes would trigger a significant increase in the profitability of firms active in the market, in part because there was a great deal of excess production capacity which could be accessed without significant reinvestment.

8. Although Breedon was not a cement manufacturer it believed that cement production was a high-value business. It estimated that the cost of building a new cement plant in Great Britain would be between $[✂] and $[✂] million. It expected cement plants to have EBITDA margins (pre-overhead) of between [✂] and [✂] per cent, aggregates businesses to have margins of [✂] to [✂] per cent and ready-mix concrete (RMX) businesses to have margins of around [✂] per cent. RMX businesses had the most expensive overheads of the three because RMX was supplied in relatively small amounts and operating an RMX business involved managing sales, logistics and quality control. The Great Britain RMX market was characterized by having a high number of plants which produced less RMX per plant than in other countries. Although RMX was by itself a low-margin business, it provided a route to market for cement and aggregates.

9. Breedon's view was that margins in cement had remained high despite the economic downturn because producers had reduced their production capacity by closing plants. Producers needed their cement plants to make good returns because of the high cost of maintenance required to keep them running.

Anglo American/Lafarge joint venture remedies

10. Breedon agreed with the CC's joint venture remedies' focus on the cement market and the requirement for the divestment of a cement plant, though it did not agree that it was the Hope plant that should be sold [✂]. Breedon also suggested that the CC should have required more aggregates facilities to be divested, but it agreed with the number of RMX plants which were to be sold.

Cement

11. Breedon bought cement from [✂] and, mainly in Scotland, [✂]. Breedon had good relationships with all its cement suppliers. It considered that the prices it paid for cement were competitive. The price it paid for cement in Scotland was slightly higher than that in England because it mainly used one supplier there and cement had to be transported to some plants in remote areas.

12. [✂]

13. Breedon did not regard any one of the Great Britain cement producers as being a price leader. It noted that fixed-price cement supply agreements rarely lasted more than two to three years.

14. Breedon competed with its cement suppliers in the RMX market in many areas throughout Great Britain. The level of competition in RMX did not appear to affect Breedon's cement suppliers' behaviour towards it. Breedon had not encountered any problems with obtaining cement for its RMX plants during periods of heightened RMX competition with its cement suppliers.

15. Breedon did not currently buy imported cement as it found that importers were unable to match domestic producers' prices. This was partly due to the location of Breedon's RMX plants, and because it considered that it received a competitive price from its Great-Britain-based suppliers. Breedon had worked hard on its procurement practices and this, along with being a larger customer with a good payment record, had helped it to secure competitive cement prices.

16. Breedon was not aware of any evidence that the Great Britain cement suppliers were coordinating in any way. [✂]

17. Breedon might every so often move one or two of its plants from [✂] or vice versa, but the amount of cement it bought from each of them was fairly stable. This was largely due to geography, as some of Breedon's RMX plants were closer to [✂], while some were closer to [✂].

18. [✂] It noted that while Lafarge was the only company making cement in Scotland, other suppliers had rail-heads which allowed them to supply the Scottish market. However, Lafarge was willing to supply all of Breedon's RMX plants, many of which were located in the north of Scotland, and which others could not supply easily.

19. [✂] CEM II (PFA-blended cement) was a substitute for CEM III (GGBS-blended cement) in most instances.

Aggregates

20. Quarries with rail links could allow aggregates producers to set up depots or 'virtual quarries' in areas of the country where they did not own a quarry and allow them to supply material that would not normally be available in that area (eg crushed rock in the South-East).

21. It was difficult to gain permission for new greenfield aggregates sites. Breedon had found it easier to obtain extensions to its existing quarries. There were a large number of small, in some cases single-quarry, aggregates producers which larger companies could acquire.

22. Aggregates markets were local as aggregates were normally only transported around 30 to 40 miles, so in a given area the majors or other larger aggregates producers might not have any advantage over smaller producers. Very large quarries would have much lower cost bases than smaller quarries and therefore have a competitive advantage.

23. Breedon bought from and sold aggregates to [✂], but it currently did less business with [✂]. Prior to its acquisition of C&G Concrete (which had its own sandpit), Breedon had sometimes struggled to obtain sand for its concrete plants in the East Midlands. Breedon did not have any reciprocal sales agreements with any producers. It also bought a small amount of aggregates from [✂] and high-PSV stone from [✂], but these were single, local, transactions and not part of larger arrangements.

24. Breedon considered itself to be better at customer service than the majors. The vertical integration of the industry which had taken place over the past few years had meant that the majors had become more focused on supplying their own businesses rather than independents.

25. For lower-grade products (eg fill, sub-base), recycled and secondary aggregates were fully substitutable with primary aggregates. The advantage given to recycled and secondary aggregates by the aggregates levy had made it challenging for primary aggregates producers to manage their stocks of lower-grade aggregates and to be able to sell them at a viable margin. Recycled and secondary aggregates were not really suitable for higher-grade products such as concrete and asphalt. RMX producers needed to be sure of the consistency of the aggregates they were using as this contributed to the strength of the concrete they produced. Breedon thought that recycled aggregates would continue to be used for lower-grade products for the foreseeable future. The amount of material currently being recycled was unlikely to increase further, so it would be difficult for recycled and secondary aggregates to gain a greater share of the overall market.

26. Having more aggregates producers in a given area would increase the level of competition. Breedon was not aware of an absence of competition in the areas where it operated. Because of current economic conditions, producers were transporting aggregates greater distances than they had previously. Breedon was not aware of a difference in how majors and independents competed, but it did note that independents (which might only have one quarry) were likely to be more focused on maintaining their sales levels even if their margins were very low because it was the only business they had. Up to 30 miles was the normal catchment area for an aggregates producer. Beyond 30 miles it was difficult to make efficient use of a haulage fleet which would lead to higher costs.

27. Breedon did not currently have concerns about the Managed Aggregates Supply Scheme or the rest of the planning system even though the process was lengthy, required early engagement with local planning authorities and could be costly. Planning authorities might not want to grant permissions to more than one producer in their areas within too short a space of time, so there was an element of competition with other producers as well.

28. Borrow pits were temporary quarries set up by contractors for particular projects. For example, if when building a road the contractor found that an area adjacent to the site contained suitable aggregates it was possible for the contractor to obtain a temporary planning consent to extract them. A borrow pit could only be used for the duration of the project and would be restored when the work was completed. The amount contractors expected to be able to supply from borrow pits often formed part of the negotiations aggregates suppliers would have with them. Sometimes, contractors were not able to obtain as much material from borrow pits as originally thought and would have to enter into further negotiations with their aggregates suppliers for additional material.

Ready-mix concrete

29. To serve smaller customers Breedon ran a small mini-mix operation, but it did not operate nor currently have any plans to operate volumetric trucks.

30. [✂] It priced transfers of its own aggregates to its RMX business at what it described at a 'quasi-market' rate which was close to what it would expect to pay to source aggregates from the open market. Breedon would not set up new RMX operations in areas where it could not access its own supply of aggregates.

31. Independent RMX producers were able to survive competition from the majors because they ran dedicated businesses which operated in small geographic areas and provided very high levels of customer service, which in turn encouraged customer loyalty. They would buy aggregates as cheaply as possible, sometimes from independent aggregates producers rather than the majors.

32. Breedon had a number of loyal customers who regularly ordered RMX from it. Sometimes these customers would test the market to see if Breedon was offering them the best price. Some other customers would always look to get quotes from a number of suppliers before deciding which one to use. [✂] Breedon did have an RMX price list, but most of its customers simply contacted its sales office to ask for a price. Larger jobs would often involve tendering processes. Breedon sold very little RMX directly 'off the price list' as it would usually need to speak to customers about their requirements before quoting them a price.

33. In most areas of the country, including rural ones, an RMX plant would face competition from at least three or four rivals.

34. High-specification concrete was normally ordered by large construction companies, and the majors all had technical staff who would work with these companies to provide them with concrete which met their particular needs. Breedon could also supply this market, but smaller RMX producers might struggle to do so as they would not have the technical resources. Breedon considered that high-specification RMX was a fairly small segment of the overall market.

35. The economic downturn had hit the RMX sector particularly badly, and it had become even more competitive. Many RMX plants had been closed or mothballed. Prices for aggregates and cement had risen because of rising energy costs. RMX producers which did not have their own supplies of aggregates would not be able to sell aggregates (which were more lucrative) along with their RMX as, for example, Breedon could. Despite the difficulties, some independent RMX producers were doing very well.