AGGREGATES, CEMENT AND READY-MIX CONCRETE MARKET INVESTIGATION

Summary of hearing with Robert Brett & Sons held on 19 September 2012

Background

1. Robert Brett & Sons Ltd (Brett) was a UK construction materials company that operated through three main businesses: Brett Aggregates, Brett Concrete and Brett Landscaping. It was a longstanding privately-owned family business.

2. Brett Aggregates operated 25 aggregates sites in the South-East of the UK, including the counties of Kent, Essex, Suffolk, Surrey, East Sussex, and parts of south and east London. It also operated two asphalt plants in Kent. It extracted sand and gravel in the South-East from quarries and marine dredging. Brett purchased hard rock from suppliers in the UK, France and Scotland.

3. Brett Concrete operated around 20 ready-mix plants in the South-East. Brett imported about 50,000 tonnes a year of ground granulated blast furnace slag (GGBS) from Holcim in Germany.

4. Brett's landscaping business was national and operated from four main manufacturing plants: Kent, Dorset, Leicestershire and North Yorkshire.

5. The length of the economic downturn in the construction industry was unprecedented. For instance, demand for Brett's aggregates, concrete and block paving had reduced between 35 and 45 per cent since 2008. The industry had overcapacity which it, including Brett, had sought to reduce. Brett had mothballed various plants and had reduced its headcount by about 35 per cent. Brett considered that the market would remain flat in 2013 though a further decline was possible as there was an element of softness in the market.

6. Brett noted that it consistently received good feedback from customers about its product offering, product quality, and service level. It had long-term relationships with customers and a very stable workforce. [✂]

7. Up until 2008 Brett had been focused on growing its business both in terms of size and geographic spread, and to this end it had acquired a number of businesses. In contrast to many of its competitors, it continued to try to gain new planning permissions and secure minerals for future use. As a family-owned business Brett took a long-term view about its profitability and growth, unlike some of its competitors who appeared to run their businesses on a short-term volume and cash-led basis.

8. [✂]

9. Brett had made a number of acquisitions in the last ten years. As an independent family-owned business itself, Brett was often seen as an attractive purchaser by other, smaller, family-owned businesses as they would perceive Brett as having similar values to themselves. The three main sand and gravel and ready-mix acquisitions it had made in the last few years were Greenham Construction Materials, Alresford Sand & Ballast, and Wildings. Brett had also been approached by other businesses that were looking for it to purchase them.

10. The greatest competitive threat that Brett currently faced was that it would not be able to secure cement supplies at competitive prices. This was because cement made up a significant proportion of its cost base. Brett noted that the company, as a whole, had been not been profitable for a few years as a result of the downturn, oversupply in the marketplace and price pressures. [✂]

11. The industry was increasingly shifting towards the greater use of recycled and secondary aggregates, partly as a result of increases in the aggregates levy. This presented a challenge for Brett, but it would adjust its business to accommodate this change.

12. Brett was a partner in five joint ventures (JVs)/partnerships.

    (a) Britannia Aggregates was a 50/50 JV with RW Aggregates Limited (which was 50/50 owned by Lafarge and Boskalis Westminster Limited). The rationale for that JV was to ensure sufficient utilization of a dredger.

    (b) Shepperton Aggregates was a partnership with Tarmac. The rationale for that partnership was to combine its processing plant with Tarmac's reserves.

    (c) Brett Hall Aggregates was a 50/50 JV with Cemex. The rational for that JV was to ensure sufficient utilization of a wharf in Dover.

    (d) Brett/Lafarge was a 50/50 JV with Lafarge. The rationale for that JV was to ensure sufficient utilization of a sand and gravel quarry.

    (e) Volker Dredging was a 50/50 JV with Van Oord. The rationale for that JV was to secure reserves of marine aggregates for future use.

13. The swaps of ready-mix concrete (RMX) plants which had occurred were, in Brett's view, driven by cement producers interested in securing RMX plants near to their centres of cement production.

Aggregates

14. Brett operated a marine terminal at Cliffe in Kent, which had a rail link. Around half of the material which arrived at the terminal was used in London. Brett also received marine aggregates to deep wharves at Ipswich, Northfleet and Dover. Brett imported rock into other wharves, such as Ramsgate, Whitstable, Ridham and Ipswich. Brett purchased rock from three quarries in France and subcontracted the shipping. With favourable exchange rates and prices from French suppliers, Brett could supply the South-East with a competitive alternative to other competitors who sourced hard rock from elsewhere in the UK, such as Scotland.

15. The most efficient way to transport aggregates depended on how far they had to be moved. Road was preferable for shorter distances up to 30 miles, followed by rail for longer distances, and sea for even greater distances.

16. Brett self-supplied most of its aggregate requirements, but it did import rock, partly to supply its asphalt plant. Brett considered itself to be a general aggregates supplier and offered a range of materials, including sand and gravel, hard rock, and recycled and secondary aggregates, which it would sell directly to customers.

17. The main aggregates required for asphalt production were imported rock and dust, therefore, Brett's asphalt business was quite separate to its RMX business, which used sand and gravel produced by Brett. Brett's asphalt business allowed it to import

more rock than it needed for its aggregates business, which made the use of its wharves most cost-effective.

18. Brett also sold on secondary and recycled materials that it purchased from a number of sources. Most of these materials needed to be processed before they could be re-sold. The South-East, particularly London, was a constant source of recycled aggregates. Brett used some recycled aggregates in its asphalt production.

19. Brett did not use recycled aggregates in its RMX because it tended to produce concrete for higher-specification work, which did not allow for the use of RMX containing recycled aggregates as it would not meet the required specifications. Recycled materials could possibly be used for lower-specification RMX, as the degree of consistency of the raw materials would be less of a concern. To use recycled aggregates in RMX producers would need to check the consistency of the recycled material at its source to ensure that it met the required specification. Also, some RMX plants would need to be adapted to handle recycled aggregates.

20. The majority of Brett's sales of recycled and secondary aggregates were to construction contractors to be used in bases or as fill. It also sold some recycled aggregates to volumetric truck operators whose customers did not require high-specification concrete.

21. Brett estimated that [✂] per cent of its aggregates production was sold internally to its RMX outlets and its landscaping business. About [✂] per cent of Brett's aggregates sales were to external customers such as RMX, pre-cast concrete, asphalt and bagged aggregates producers.

22. With external customers, Brett tended to negotiate prices on an annual basis. Negotiated prices were primarily based on anticipated production costs and supply volumes and were also correlated to changes in the local competition conditions. Customers that had lower switching costs, such as baggers, had prices that were aligned more closely with market prices. Also, in the current marketplace, even pre-cast concrete manufacturers, with higher switching costs, were tendering work more regularly. The prices Brett was able to achieve were related to the number of competitors they faced in a given area.

23. Brett used price increase letters to make a formal statement about prices to the market. Brett was in constant communication with its external customers, so some customers would know well in advance the likely size of a price change, the reasons for it, and Brett's expectations going forward. Brett would always negotiate price increases with individual customers. The market had been very competitive over the past few years and it had been difficult for Brett to achieve price increases.

24. Brett competed with the majors in aggregates, and it took some notice of the price increase letters they sent out. Brett tried to be upfront with its customers and offer realistic price increases, so it could have sensible one-on-one negotiations with each of them. It considered that some of the increases sought by its competitors were unrealistic.

25. When sales volumes fell in a marketplace companies' commercial strategies tended to follow a certain route. First, producers reduced their production, but even so there might be a large build-up of unsold stock. This then led to producers trying to reduce their stock at reduced prices. This could lead to customers switching producers to get the best price they could. Producers then mothballed plant to remove excess capacity, so over time supply and demand came back to an efficient balance.

26. In a downturn one of Brett's strategic drivers was to maintain stable prices. It tracked its market share against what was happening in the market, and did not chase volumes when demand was down so long as its market share was stable. [✂] Aggregates pricing was ultimately cost-driven, and each producer would have different costs, and different ways of calculating its prices, depending on the geology and location of its reserves.

27. The majors' pricing policies varied. They all had different reserves, so the quality of their products and their cost bases were different. One major would sell at low prices to gain volume and would see its market share increase as a result. However, Brett would try to sell, whether internally or externally, at what it considered to be the 'market clearing price', but this was not the case with some of the majors which charged high internal transfer prices, but charged marginal prices to external customers.

28. Aggregates that were not sold to external fixed-outlet customers were usually sold on a tendered basis to contractors for use in building and infrastructure projects. Brett would base its prices for these tenders on the availability of materials, production and reserve implications, and the need to achieve an adequate margin. Brett also made some sales directly to small building companies.

29. Obtaining planning permissions was very costly in terms of time and money. An application for a new quarry needed to deal with, and militate against, the concerns of and opposition from local councils and numerous interest groups. If a reserve was included in the local area's minerals plan then permission could be gained relatively quickly, but if it had not been allocated in the minerals plan it would likely take a decade or more to receive the necessary permissions.

30. The new National Planning Policy Framework had come into effect in March 2012. It talked about preventing monopolies (or duopolies) in terms of access to minerals in a given region. Local mineral planning authorities now had to consider whether the reserves in their areas might be controlled by a small number of operators.

31. The Managed Aggregates Supply System gave each mineral planning authority an obligation to deliver a land bank which would supply its area's aggregates needs for a given time. Brett's view was that any reduction in the size of a land bank would increase the degree of concentration, but it was not aware of evidence suggesting that the majors had a strategy of trying to acquire overly large portions of land banks. It also noted that the majors had recently not been as proactive in looking to obtain permission for new sites or extensions.

32. However, there were differences between crushed rock quarries, which could be exploited for tens of years, and sand and gravel quarries which would normally only be used for around 10 to 12 years. New crushed rock quarries had much greater environmental pressures than extensions ones, and this meant that crushed rock quarry owners, if they timed their applications for extensions for when the area's land bank had been reduced, could practically guarantee that they would be granted.

33. There was a cost to leaving aggregate reserves unexploited which would include internal charges to the plant and possible minimum royalty charges to the landowner. These costs were considered before a site was mothballed or amalgamated to improve efficiency. Brett would consider mothballing a site if demand for its aggregates had reduced by around 40 per cent. Sites could be closed within three months, but the act of mothballing a site and laying-off staff also involved costs.

34. Brett said that borrow pits could provide a competitive advantage for particular projects as they could be used as leverage in negotiations with an aggregates supplier by a construction contractor, but the contractor would need to have the right expertise to exploit the borrow pit.

35. Brett had not entered into any asset swap arrangements with any other aggregates businesses.

Ready-mix concrete

36. Competition in the RMX market was dependent on the number of competitors, how busy the market was and competitors' strategies. [✂], for example, sold its RMX cheaply in order to increase its cement sales. Brett monitored how much business its competitors had and then positioned itself to obtain the types of contracts it wanted which would enable it to obtain the best RMX price it could.

37. Brett considered that it competed with a mixture of the majors and independents in the South East, including Hanson, Cemex, Tarmac, Lafarge, Eastern Concrete, Euromix and Mix-N-Lay. The degree of competition was dependent on the nature of the contract. For example, [✂] could win the right to supply large projects as it was an international company with a good plant network which gave it credibility when dealing with major contractors and an advantage over the independents. Major contractors would also regularly speak with Brett. Whereas other independents, which also had an emphasis on customer service, were very competitive for smaller and lower-specification projects.

38. Value-added RMX products were currently only a small part of Brett's overall RMX sales, but it ensured it could supply customers who needed them. Brett did not currently operate volumetric vehicles but continually assessed the feasibility of this option. At the present time, volumetric truck operators were not bound by the same regulations as other heavy goods vehicles and this gave them a competitive advantage.

39. There was a lot of customer churn in the RMX business, although there were a number of customers that had preferred suppliers. Brett scored well in many customer surveys so it believed it had a higher proportion of loyal customers than its competitors.

Cement

40. The majors were selling cement (and aggregates) to their RMX business at a high transfer price, while their respective RMX businesses operated at a loss. Brett's RMX businesses also operated at a loss but its transfer prices were market prices.

41. Despite the majors' high internal transfer prices, Brett submitted that RMX was sold to customers at a low price, which represented a cross-subsidy from the majors' cement businesses into their RMX business. Brett and other independent RMX businesses had difficulty in competing with the majors' RMX pricing because of the cross-subsidy, even though the internal transfer price looked high on paper. Over the past five years the overall price of cement to external customers had gone up, however, the overall price of RMX had gone down.

42. Brett noted that the above was not inconsistent with an increased market share for the independent RMX sector. This increased market share was due to independents taking advantage of market conditions by purchasing cheaper aggregates and

cement, through stock dumping, and finding lower-specification work in high-volume market places, such as London.

43. The RMX market had also become more competitive since the downturn and this had affected the pricing of RMX more than the increases in the price of cement.

44. Brett currently purchased its cement from Lafarge. Brett considered that it might get a good price from Lafarge in part because Lafarge had fewer RMX plants in the South-East and less overlap with Brett's RMX operations than other suppliers. However, from Brett's point of view, Lafarge had shown a commitment to working with Brett in the long term, which Brett valued because it wanted to ensure the stability of its cement supplies.

45. Brett had a non-exclusive cement supply contract with Lafarge [✂]. Lafarge charged Brett a delivery price for its cement on a per RMX plant basis [✂]. Brett also had the option to import cement, through its terminal at Sittingbourne in Kent, if necessary. [✂] Lafarge supplied Brett with cement from its plants at Le Havre in France and Hope in Derbyshire.

46. Brett only purchased CEM I from Lafarge. It also imported GGBS from Holcim in Germany, which it only used to make CEM III for used in its own RMX plants.

47. Brett's import terminal operated at 50 per cent capacity. [✂]

48. Brett had previously purchased imported cement from a company called Paragon. When Paragon was acquired by another company, Brett set up its own import terminal in order to retain the leverage for cement negotiations that its imports from Paragon had previously given it. Brett was unable to switch to another cement importer at the time of Paragon's acquisition because there was no suitable alternative. Brett had a preference for domestic cement over imported cement in part because of security of supply.

49. Brett received price increase announcement letters from Lafarge, despite there being regular communications between the parties. The issuing of price announcement letters by the major cement suppliers was helpful to Brett in its negotiations with its customers, as the overall construction industry was informed (via the trade press) about these increases.

50. Brett had observed how the majors could use their vertically integrated business model to balance their respective positions in the market place.

Anglo American/Lafarge JV remedies

51. The effect of the remedies could not be anticipated. Lafarge, as a result of the JV, would have more opportunities to vertically integrate its businesses. [✂]