COMPETITION COMMISSION

AGGREGATES, CEMENT AND READY-MIX CONCRETE MARKET INVESTIGATION

Summary of hearing held with Cemex on 7 December 2012

Introductory comments and general questions

1. Cemex addressed the difficult UK market [✄]. The market had continued to tighten in 2012 [✄]. Input costs had continued to rise; Cemex expected electricity costs to increase by £[✄] and the next phase in the European Carbon Trading System (EU ETS) would have a [✄] impact. [✄] The market was not over-profitable and the London market behaved differently to that of the rest of the UK. The outlook overall was significantly worse than that foreseen at the first hearing.

2. There had been a significant expansion in imported cement in the UK market—two new import terminals had opened in the last six months (Montrose—Dudman, and Kent—Quinn). Cemex believed that the new importers sourced cheap cement from the Republic of Ireland where some producers achieved the 50 per cent production necessary to ensure that they received free carbon credits, which led to excess cement. The impact of the EU ETS should not be downplayed as the threshold of 50 per cent had a significant impact on markets which had low utilization and incentivized imports into the UK. Price was the main factor when negotiating with customers, and customers used the availability of imported cement to negotiate prices down. The CC needed to accept the competitive constraint applied by importers in its analysis.

3. The joint venture between Lafarge and Tarmac, and the entry of Mittal, would have a profound effect on the Great Britain cement market. It was not possible to predict the outcome of these events, and therefore there was significant uncertainty about how the market would behave in future. The industry would be different from the one initially under investigation.

4. Cemex largely ran its businesses independently [✄]. It agreed with the CC's analysis on aggregates that the regulatory policy framework for the industry did not hinder competition.

[✄]

5. [✄]

Aggregates

6. The use of secondary and recycled aggregates in ready-mix concrete (RMX) was more widespread than CC had indicated in its report and this should be included in a wider market definition for aggregates. In Cemex's experience, it was easier to obtain planning permission for existing quarries than obtaining permission to open a new greenfield quarry; Cemex accepted that this created an advantage to those already in the business. Though Hanson had extended quarries in the past two years, it had not opened any new ones due to the downturn in trading conditions. Some of its quarries were rail-linked and this was advantageous in transporting hard rock into its London depots as there was no hard rock in or near London; aggregates supplied to depots could then be sold on the open market which meant having a rail depot was the

equivalent to another competitor in that particular marketplace; rail-linked depots could be viewed as ‘virtual quarries’.

7. Aggregates transported in depots by rail were [✂].

8. The price paid for aggregates depended on the volume that was purchased by the customer; the more purchased the lower the price. Cemex expected to see lower prices in areas with a high concentration of competitors though it said prices were already at competitive level which meant entry and exit might not affect price. Cemex did not differentiate between independents and the other Majors; a competitor was a competitor regardless of size, it also viewed merchant hauliers as competitors. The presence of recycled aggregates in a market drove down the price of virgin aggregates, as recyclers needed to sell material as soon as possible. Recycled aggregate producers had the ability to drop their prices slightly underneath Cemex’s, as the £2 aggregate levy on primary aggregates gave recyclers an advantage.

9. [✂]

10. [✂]

11. In comparing Cemex’s internal and external prices for aggregates, care needed to be taken since exactly the same sub-type of aggregate could be used in high-value applications such as clean aggregates for RMX production, and lower-value applications such as fill; [✂].

Profitability

12. Cemex told us that it [✂].

13. [✂]

14. Cemex had an understanding of its competitors’ haulage and logistical costs but it did not have information regarding manufacturing costs, overheads, corporate costs and capital costs [✂].

15. [✂]

16. Cemex accounted for its carbon credits centrally at the European level and not at the UK level. The carbon credit income recorded in its UK accounts reflected a notional European transfer revenue and not necessarily the revenues raised from the sale of its excess carbon credits.

17. Cemex told us that it had [✂].

18. Cemex said that volumetric operators were now more common in the market and had positioned themselves to do bigger, more complex jobs.

Cement

19. Cemex told us that [✂].

20. [✂]

21. [✂] price increase announcement letters were used as a starting point for negotiation with customers. [✂]

22. The correlation in prices in the market was due to the competitiveness of the market, and the industry had similar drivers—the same fuel costs, planning costs, fixed costs—therefore prices to recover cost increases had similarities. However, Cemex pointed out that there were examples of 25 per cent differences in prices increases among the Majors. [✂] As Cemex negotiated individually with customers, price announcement letters did not have any impact on the pattern of realized prices throughout the year; [✂].

23. The CC's analysis took into account cash variable costs but Cemex said that this only told part of the story. [✂]

24. [✂]

25. [✂]

26. [✂]

27. All customers in Great Britain could use the threat of switching to imported cement to drive prices down. So imports had a much bigger role in the Great Britain market than their market share indicated, which was currently at [✂]. Packed and now bulk cement were being imported into Great Britain from the Republic of Ireland in trucks, so even the minimal investment needed for an import terminal was no longer required, as Irish importers simply brought tankers over via ferry and then took the empty tankers back. [✂]

28. It seemed likely that the ETS was driving at least some of these additional imports, with importers appearing to price at variable cost—or possibly below variable cost, given the location of some of the customers importers had recently won; importers recovered their fixed costs from their domestic sales then were incentivized to sell into another market on a marginal cost basis knowing it was not going to impact on the price at which they were selling into the domestic market. [✂] Though the Irish market had fallen through, the value of the ETS common credit meant Irish suppliers produced at 50.1 per cent and then sold the surplus into the UK market at much lower prices than domestic producers. Cemex believed that the implications of ETS had caused inefficiency as it potentially encouraged cement producers to run two kilns at 50.1 per cent capacity instead of one kiln at 100 per cent capacity.

29. Cemex distinguished between two types of cement importer—those that were part of cement manufacturers abroad, and those that were merely traders. Importers that were part of an overseas cement manufacturer sometimes decided to sell at a marginal basis into the UK because their fixed costs were covered at home. Import traders were concerned with variable costs; if they purchased cement for a good price anything sold was margin.

30. Cemex told us that the data might show that importers priced just below the Great Britain producers—this was the outcome rather than the starting position, [✂].

31. Any strategy by the Great Britain producers of excluding importers did not appear to have been successful, given the growing market share of importers; [✂].

32. Cemex explained that the documents the CC relied on were old. What the CC had observed in relation to what it had thought was coordination was in fact rational behaviour in a high-fixed-cost business with difficult trading conditions which had resulted in the Majors making similar decisions.

33. [✂]

34. [✄], Cemex told us that customers did not currently demand GGBS specifically. Cemex said that Mittal might have its own source of GGBS.

Impact of the entry of Mittal

35. Cemex assumed that Mittal could afford further investment due to its very efficient asset base, and the advantage of owning a low-cost plant. Unlike Tarmac, Mittal could target external customers effectively, and they would be economically vertically integrated into RMX; Cemex believed that Mittal could acquire some aggregates suppliers.

36. Whilst the joint venture remedies meant there would still be the same number of cement producers in the UK, Cemex said the market would change due to different strategies, and different business plans, particularly due to Mittal entering from a different industry. Mittal's entry might help counterbalance any risk of coordination in the cement market. Cemex highlighted that the joint venture final report identified three reasons that a new entrant using Hope might increase competition in the market: Hope's larger capacity compared with Tunstead; uncertainties over the new entrant's business strategy; and the fact that Hope had never been previously run as a stand-alone business (increasing the uncertainty about how its cement production might affect competition in the market).