

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

Summary of hearing held with Hanson on 3 December 2012

Introductory comments and general questions

1. Hanson referred to the letter submitted by the Chief Executive of Hanson to the Chairman and the Group in early December 2012. This discussed and highlighted the current and projected adverse trading conditions, the recession and the enormous declines in volumes and fluctuations in demand, and the great levels of uncertainty and huge changes in the market. The Chairman acknowledged receipt of the letter and confirmed it would be considered appropriately by the Group.
2. Hanson was surprised at the observations the CC had discussed in the published Updated Issues Statement, regarding cement importers. It believed that the CC's position on cement importers was significantly understated and that there was a disconnect between the provisional views of the CC and the realities of the impact that importers were having on the cement market. Hanson viewed importers as a strong competitive threat within the industry, which had continued to expand capacity and facilities and whose volumes had flourished across the UK. New importers were still entering the UK and represented at least 13 per cent of the UK market. Hanson referred to the European Commission's express recognition of the role that importers played in the market definition and, like the European Commission, viewed importers as a strong contender within the cement segment of the marketplace.
3. Hanson wished to address a key point raised by the CC—it said that an undue amount of attention had been given to the events towards the second half of 2008 into 2009 where Hanson had taken its decision to maximize its own profitability and efficiency by internalizing its existing supply from Lafarge. Hanson explained that this was a unique although natural occurrence, which had resulted from Heidelberg's acquisition of Hanson, causing Hanson to become vertically integrated with its cement operation for the first time; Heidelberg's strategy of vertical integration was clearly understood; it had involved acquisitions and therefore Hanson's internalization of its cement supply was a move which was always going to happen in the UK once Heidelberg had acquired Hanson. Hanson said that this was not representative of any form of current or historic behaviour in the market, and the significant transfer of volumes in house had inevitably led to major change and upheaval in the market. The CC had not appreciated the full background to or the full facts surrounding the internalization and used the hearing to understand this further.
4. In relation to the regulatory policy framework for the industry, Hanson said that it was clearly a level playing field, where the same rules applied to all. With regard to aggregates, it was not known whether many new operators would wish to enter the market, as the process of securing new permissions could be difficult and costly. However, it was a level playing field for all.
5. In relation to the EU Emissions Trading Scheme (EUETS), Hanson explained that importers from countries such as the Republic of Ireland and Spain often ran cement operations uneconomically, in order to increase levels of capacity and supply purely to generate the benefits of the windfall revenues from carbon allocations; EUETS had an impact if one ran an operation in the UK or elsewhere in the EU, since a producer could run operations sub-optimally and increase supply, purely to preserve carbon

allocations. Hanson pointed out that the EUETS could therefore boost capacity and therefore imports from Spain and the Republic of Ireland.

Aggregates

6. Hanson said that the planning regulations tended to work currently along the lines of extending existing permissions rather than being granted green-build ones, though barriers to entry for recycled aggregates were very low and it was also possible for aggregates competitors to take advantage of short-term lease sites and lease equipment (which involved operating someone else's leased reserve and using mobile equipment) in order to enter the market without difficulty.
7. The National Planning Policy Framework (NPPF) had introduced the concept that if large land banks were in any way being bound up with very few sites, it should and could not stifle competition, given the existing direction and legislation providing for local planning authorities to vary and revoke consents. This provided an impetus and existing direction to the local planning authority in that area, to grant more permissions if that should ever be a concern. [REDACTED]
8. Hanson's strategy [REDACTED].
9. The lowest cost of moving material was by railway; Hanson had a principal quarry where it moved material by railway, which was in Somerset, [REDACTED]. Most of Hanson's material from rail-linked depots was used internally by Hanson, as its rationale for being in this business was vertical integration; Hanson sold aggregates on the open market where economic. Rail depots did not dictate prices for aggregates in Hanson's areas, but prices were determined by demand and supply in the relevant markets through competition with other suppliers in the area. The London market was particularly competitive due to other competitors who had rail-fed materials, due to competing materials from the Home Counties and Essex, and due to the prevalent use of secondary and recycled aggregates. Movement of material along the railway line was not always for the purpose of specialist aggregates. Hanson had a high PSV quarry in South Wales; that material tended to be moved from that quarry to a depot and then along the railway.
10. [REDACTED]
11. With regard to the presence of independents, Hanson said that aggregates markets varied a great deal locally, so it was difficult to generalize about the role of independents in local aggregates markets, although there was clearly a huge number of independents across the markets. Competitive pressures varied according to how the independents drove their own strategies. Independents' strategies varied within certain geographical markets, from high-volume, low-price models, to a very high-price model with little exhausting of reserves. There were strong long-standing allegiances between some customers and some small independent family-owned companies which were less likely to switch to one of the Majors, though Hanson believed there were hardly any long-term supply agreements within the aggregates market, and so no suppliers could ever assume that they would keep contracts from commencement to conclusion. Many of the independents were sizeable businesses in themselves, and often had a market share within certain geographical areas which were equal to the Majors operating in such areas.
12. [REDACTED] This agreement was not typical of the aggregates market generally. Network Rail tended to seek three- to five-year rail ballast contracts, though Hanson did not currently have any contracts with Network Rail. Such formal term supply agreements for aggregates were rare, so customers were able to always switch freely.

13. The impact of recycled and secondary aggregates on the sales of Hanson's lower-grade products was significant, due to the £2 cost advantage and incentive provided by the aggregates levy. Recycled aggregates producers had market knowledge of the price of virgin low-grade material, and priced accordingly to win business. Recycled aggregates producers sold demolition site material within a fixed time period through the availability of such demolition waste, often at a low price. However, materials were also crushed and transferred to depots for longer storage periods. Hanson believed that the CC needed to be aware of how recycled aggregate had grown and flourished in the marketplace as a result of the introduction of the levy (also as a result of very low barriers to entry for recycled aggregates); its selling point was effectively zero up to quite a significant proportion.
14. The recycled aggregates sector had matured due to the levy and also due to the sustainability priority in the market. Recycled aggregates now tried to compete with primary aggregates, particularly to try and take advantage of the sustainability agenda, where government contracts and local council contracts specified recycled material in the interests of sustainability. Recycled aggregates was now a specified product requirement, which meant that it could now even be priced alongside premium aggregates as it moved up the quality spectrum.
15. [REDACTED]
16. [REDACTED]
17. Hanson's national price announcement increase letters were a starting point for negotiations with customers. It was calculated as a purely cost-based indication that it would be seeking to try and recover the cost inflation in order to maintain its margins, and this would normally take place on 1 January. Prices were often then negotiated with regional inflation in mind. Hanson was sometimes aware of its competitors' price increases in the instances where Hanson received the letter as a buyer, and also sometimes Hanson might receive feedback from its own customers. Customers used Hanson's competitors' price announcements as a bargaining tool during negotiation, in order to drive down Hanson's sale prices and ensure that the supplies remained competitive; the current environment was certainly a buyer's market and it was difficult to sustain price increases as buyers were extremely aggressive.
18. [REDACTED]

CC published conclusions on cement profitability

19. With reference to the CC's preliminary profitability analysis for cement as published, Hanson said that the CC's profitability assessment had to be work in progress as it was yet to be completed before any conclusions could be voiced. Asset valuations should be assessed on an MEA basis, rather than the historical cost approach which was an inappropriate methodology on which to assess profitability. Hanson's revenue from the sale of carbon allocations had to be treated as exceptional or extraordinary windfall income and excluded from the relevant profitability and ROCE calculations, if a proper assessment of profitability was to be completed. [REDACTED]
20. [REDACTED]
21. [REDACTED]
22. [REDACTED]

23. [REDACTED]

Cement

24. Hanson said that in the current climate it was difficult to envisage anyone building a brand new cement plant in the form of a clinker production works, given the severe adverse changes in the market and the decimations in volume and demand; the market needed to become much more buoyant before this could be attractive, and there was no such expectancy. The use of excess capacity at existing plants had become less viable and this appeared to be the case for the other Majors too; a lot of excess capacity was now considered useless. [REDACTED]
25. [REDACTED] The performance of Hanson's RMX business had a significant impact on the performance of Hanson's cement and GGBS business, since RMX provided a major route to market for Hanson's cement; [REDACTED].
26. Hanson did not see market share as the predefining or priority metric of its business performance; the market could be segmented and it could be regionalized, and this could command different margins. [REDACTED] Hanson's repatriation of cement in 2008/09 meant that it had moved away from being a large buyer of cement, to reduce that external purchase quickly.
27. Total market volume data was available from the Mineral Products Association (MPA) (for members of the MPA) but such data was restricted to measuring the total market based only on information regarding the MPA members. [REDACTED], to indicate likely volumes; it also sought to use local intelligence, in order to try to establish whether any market share data supplied by the MPA was inaccurate.
28. Due to the complex ownership structures of its competitors and changes in the way in which information was reported such as through statutory accounts, Hanson said that it was extremely difficult to obtain any information regarding its competitors' performance. It could establish its own market share, but could only guess the market share of its rivals at any point in time; market share information that was over six months old was considered out of date. [REDACTED]
29. Lafarge had not previously discussed the issue of market share with Hanson, and this was only raised as its goal due to the isolated unique situation which arose in 2008, when Hanson (Lafarge's then largest purchaser and customer of cement, and the largest purchaser of cement in the UK) was internalizing a significant amount of cement volume after becoming integrated for the first time on being bought by Heidelberg Cement. A lot of major changes in the marketplace occurred at that time, which meant that internalization was larger than had originally been anticipated.
30. These market conditions had led also to internalization by Cemex and Tarmac, and Hanson had lost volumes as two of its customers had taken business off Hanson to supply themselves. [REDACTED]
31. [REDACTED]
32. [REDACTED] Hanson did not see any pattern when it came to which company in the market announced its price increases first, and which and how companies followed. Cost drivers would impact most of Hanson's competitors, so a degree of price similarity was natural and expected; all competitors applied their prices as early in the year as possible, though the prices announced were seldom delivered. Ultimately, it was the customers who determined how successful the price increases were. Bagged/packed

increases were usually in advance of bulk increases as main multiples buyers required at least three months' notice.

33. In respect of the CC's statements that there was evidence of an established pattern in price increase announcement letters and that more often than not Lafarge would go first with the price increase, Hanson commented on the basis of the evidence before the CC that there was no pattern in price increase announcement letters, as Lafarge did not tend to go first with price increase announcement letters. Hanson had always independently done what it needed to do as regarded any price increase. Hanson's analysis of patterns in the price increase letters was, with respect, inaccurate and countered by the evidence.
34. With reference to the 2008 mid-year price announcement letter, Hanson said that it urgently needed to recover the very significant cost inflation that occurred during that year to date. It decided that its own announced price increase should not be discounted, as Lafarge and Cemex appeared to have both announced price increases of magnitude in excess of that of Hanson and Hanson had taken the stance not to discount prices further as its own price increases were already low relative to market.
35. Hanson's [REDACTED]; it could not comment on its competitors. Hanson's 3 per cent loss of market share over recent years was not consistent with a market with a high degree of price correlation. If prices were correlated, this was because it represented the market price for cement and it was the market and customers which set the price in effect, not the sellers of cement. Hanson told us that although cement producers may share some similar costs of production, distribution costs varied significantly between producers and distribution was a large element on the delivered cost of cement. Different cost factors also applied to whether or not one supplied into a ready-mix business, bulk cement, or a pre-cast business because of the nature of the storage capacities. [REDACTED]
36. With reference to cement prices diverging between London and the North, Hanson said that regional differences were emerging again; the economy was two-speed with demand more buoyant in London itself. At the beginning of 2012, Hanson had put a fairly high price increase on and it had lost a lot of business and share mainly in the North of the country, but had nevertheless noticed a big increase in volumes in the South, particularly from its Ketton plant.
37. Hanson's stated aim was [REDACTED].
38. The prices Hanson charged and tried to apply in its price negotiations with the other Majors were the optimum it could achieve. Tarmac issued an annual tender and Hanson was a bidder in that tender process; it did not buy any Tarmac cement, so there were no cross-selling or 'contra-balancing' considerations. Hanson supplied in excess of a third of its cement to its own internal business (leaving the cement supply to be left to the RMX route to market), around half of its cement to independents, and the remaining minority to the other Majors.
39. With reference to its internalization in 2008/09, Hanson said that this happened during a time of very rapid change; it had just found itself integrated for the first time (having been acquired by Heidelberg Cement) and the market and volumes had suffered rapid and very significant contraction, which meant that Hanson had internal capacity. Significant price increases from Lafarge had been pushed on to Hanson as a customer at the time, so Hanson ended up internalizing more quickly than it had anticipated. It carried on buying from Lafarge until the end of 2008 because it would lose the quantity discounts (volume rebates) it would have otherwise achieved. Hanson completed the internalization of its cement purchases in 2009 after initiating

the process through 2008. Hanson told us its initial plan was to internalize a first tranche of [REDACTED] (volumes most cost-effective to supply from Castle cement plants), and with such a slower rate, Hanson aspired not to lose any external sales volumes as a result. Hanson was under strong price attack for most of 2009, and it tried to defend as much as it could; it was also losing significant volumes to Lafarge's and Cemex's won internalizations, and Aggregate Industries whose price reduction aspirations (for its purchases from Hanson) became unacceptable to Hanson as Aggregate Industries was already supplied very cheaply; Hanson said that this was clear evidence that it was not prepared to hold market share at any price, profit being the key driver in clear preference to mere market share. Retrospectively, it was right to take the internalization decision at the time it did, as it meant it was now more in control of its own destiny when it came to managing its integrated business, and this was a realized benefit for Hanson.

40. Importers played a significant role in the market and were a threat and constraint at both a volume and pricing level. Hanson regularly renegotiated prices and reversed price increases with customers, due to being faced with competition and lower prices from the many cement importers; Hanson aimed to hold on to its business as long it was profitable, but was obliged to look elsewhere in the market should business be lost when it became unsustainable to meet the importers' prices. Ready-mix customers were even more attracted to importers, as switching was perhaps even easier, relative to a concrete block producer who might wish to restrict the technical changes needed in order to bring in another source of cement. Hanson had not explored the possibility of acquiring an importer as there were plenty of wharves and terminals around the UK where cement import terminals could easily be opened at any time; it was more cost-effective for Hanson to expand its current network than acquire an importer. Hanson had a long-term lease at Haden Vale which it used as an import terminal until 2007; the terminal had been well maintained on the basis that it would be utilized in the long term. The terminal had now been rail-linked and was used as a distribution depot, as part of its collective supply of the South-West.
41. For current management purposes Hanson treated GGBS as a product line within the cementitious products business. GGBS was transferred into Hanson's RMX business in the same way as cement. GGBS could be imported, and PFA could always be used instead. Hanson negotiated with Tarmac as to the price Tarmac paid for GGBS; PFA was Tarmac's alternative option. There was no minimum quantity that Tarmac was obliged to purchase from Hanson. The exclusivity and longevity of the Hanson-Tarmac GGBS supply agreement was negotiated before Hanson acquired the Civil and Marine GGBS business, and was intended to protect the very significant investments made in the GGBS production facilities, along with the high level of risk associated with the pioneering move to establish GGBS operations on such a scale. Hanson purchased C&M for about £214 million in February/March 2006, which reflected the assets (cost of equipment was worth £50 million alone) and also the considerable goodwill in the contract with Tarmac. The exclusivity and longevity was justified by the high risks C&M bore in producing GGBS and supplying it on such a national scale: there was zero guaranteed continuity of supply of slag in the UK, given the uncertainties surrounding the continuance of steel production in Great Britain, and not all British steel plants were expected to keep operating; so exclusivity across the steel plants was required, given the closure risks.

RMX

42. Hanson's RMX Managing Director was a member of Hanson's senior team [REDACTED].
43. Volumetric businesses had grown significantly over the past ten years; volumetrics had established a very strong sales base in the DIY and cash sales sectors at the

expense of the established RMX businesses which had previously supplied that market sector. Volumetric businesses now made up around 8 to 8.5 per cent of the RMX market and had shown success in running sizeable contracts in recent years; these contracts may not have had high volumes but could be many months long. Volumes of RMX did not have to be huge to justify a site plant—customers often required an element of exclusive dedicated service; site plants could also be used where traffic congestion meant that transporting RMX from a nearby fixed plant was too uncertain. Hanson had kept a national footprint of RMX sites of around 200 plants; however, it was still the case that each plant needed two men to operate it.

44. As a national ready-mix producer, Hanson could not survive on just major contracts; it needed a range of work—small, medium-sized and large contracts—across the whole geography of the country. There were not many major RMX contracts outside London. With reference to independent RMX producers, Hanson said that they had flourished and competed with it in every RMX market outside the major urban areas. Some independent RMX producers were even considered ‘majors’ within certain localized markets, since their presence and capacity were at least as significant as the Majors. It was important to remember that many independent RMX producers were themselves vertically integrated, given their own aggregates operations. Independents were more reactive to costs, which had helped in their market share growing in the past three years.
45. The RMX market in the UK had dropped by a huge 40 per cent since 2007. Hanson had maintained quite a large plant footprint for this business (which it was not planning on slimming), which had an intended fixed cost in the business, but it was a volume business, and it had lost 2 million tonnes. In order to improve profitability, Hanson focused on higher-value jobs and on improved logistics. Hanson said that if one right sized the aggregates or right priced its aggregates-to-market price, its RMX business was generally profitable.

Impact of the entry of Lakshmi Mittal

46. Hanson had not come to a view on whether it would exercise its pre-emption rights in respect of Tarmac’s stake in Midlands Quarry Products; it depended on the price Mittal had offered for that stake. Mittal’s entry created tremendous uncertainty through the markets under investigation and it was not clear where Mittal’s RMX plants would buy their aggregates, cement and GGBS/PFA. Hanson did not know Mittal’s business approach for the UK market and the extent to which it would invest heavily in or otherwise change production and distribution. Mittal’s strategy may also depend on the level of debt Mittal took on in making the acquisition; if the acquisition was debt free, Mittal may take a longer-term strategy and invest more in operations now. Hanson said that Mittal would behave very differently from Tarmac and the competition could only be significantly increased.