Grant Thornton

IRISH CONCRETE FEDERATION

Strategic Review of the Concrete Industry in Ireland

Summary Report

September 2006

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1. Executive Summary

1.1 Terms of Reference

Grant Thornton was retained by the Irish Concrete Federation to carry out a review of the concrete products and aggregate sector in Ireland. The terms of reference for the study were:

1. Update the profile of the industry by establishing a detailed account of activity levels in the industry.
2. Provide a financial profile of the industry with the intention of assessing profitability; return on investment in the industry and seeking to assess to what extent there are potential future issues such as funding the replacement of plant and equipment.
3. Review competition in the sector.
4. Gather data on the following aspects of the industry:
    i. Staffing levels and breakdown
    ii. Industry capacity and capacity utilisation
    iii. Trends in cement usage and alternatives
    iv. New product development
    v. Competitiveness with competing industries, and
    vi. Educational and training needs.
5. Identify and review emerging issues, including:-
    i. Sustainability of reserves of stone and aggregate, and how reserves may have changed in recent years;
    ii. Statutory and legislative issues;
    iii. Impact and cost of compliance of health and safety and other statutory requirements;
    iv. Development charges for quarries;
    v. Potential use of disused quarries for construction and demolition waste;
    vi. Costs and efficiency of transport, impact of legislation on transport of concrete products and stone, sand and gravel;
    vii. Impact of increased energy costs;
    viii. How the industry is dealing with planning and environmental issues;

ix. Enforcement of legislation and statutory instruments by local authorities and the State;
x. Perceived impact of the new public procurement rules;
xi. Product quality and implementation of EN206, and
xii. Any other issues identified during the review.

6. Finally, identify the priorities of members in respect of existing ICF services; and identify any additional services that the ICF might consider offering in future.

1.2 The Concrete Industry in Ireland

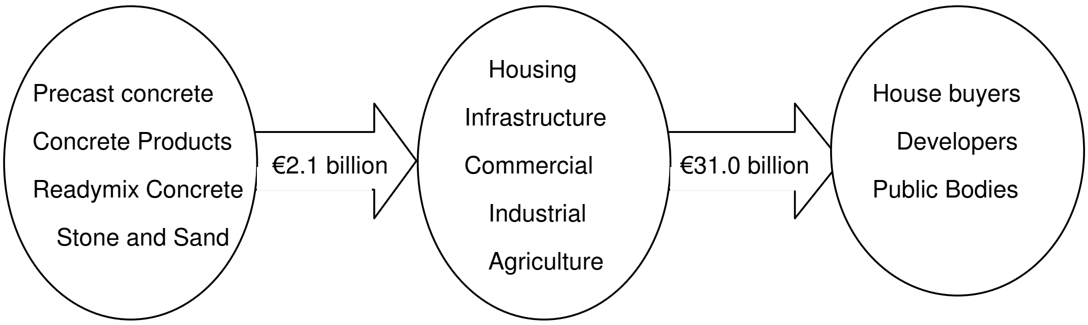
Output

The outputs of product from the concrete industry in Ireland in 2005 are estimated as follows:

	Volume	Value €m
Extraction Sector		
Aggregate, stone, sand, gravel	176m tonnes	912
Manufacturing		
Readymix Concrete	8.6 mn cu. Metres	551
Concrete Blocks	522 million	242
Precast Concrete	-	243
Other		
Incl. asphalt, mortar	-	152
Total		**2,100**

It is estimated that the members of the Irish Concrete Federation provide over 80% of the total industry output.

The value of concrete products and stone/gravel as a portion of the total construction supply chain is as follows:



Industry Growth and Prices

The annual rates of growth in the different products categories supplied by the concrete industry over the period 2000 to 2005 are shown in the following table:

Sector €Million	2000	2005	Average Annual Growth
Readymix Concrete	375	551	8.0%
Aggregate	567	912	10.0%
Blocks	168	242	7.6%
Precast	152	243	9.8%
Other	178	152	-3.1%
Total	**1,440**	**2,100**	**6.0%**

Industry revenues increased at an average annual rate of 6% between 2000 and 2005. The survey of the industry shows that output volume increases, not price increases, accounted for the major portion of the growth. Concrete product prices increased by 2.4% in total over the two year period 2004 to 2005, while output volumes increased by 7.3% over the same period. This shows that the industry was more reliant on volume growth than price increases for the increases in total revenues.

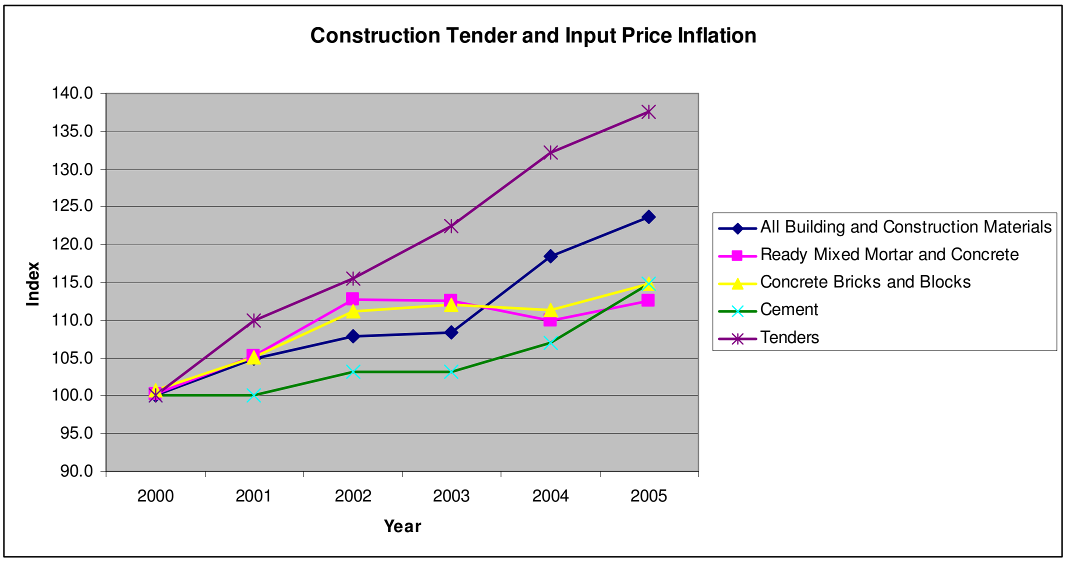
Key construction industry data for recent years are as follows:

	2002	2003	2004	2005
GDP	6.1%	4.4%	4.5%	4.7%
Construction Output	2.0%	5.3%	6.9%	9.7%
Construction Employment (000s)	191	201	227	249
Construction Material Price Increase	3%	1%	9%	6%
Construction Price Inflation	5%	6%	8%	4%
Tender price inflation - housing	10%	14%	12%	5%
Tender price inflation - civil	6%	3%	4%	4%

Although GDP has grown relatively consistently in the period 2003 to 2005, the rate of growth in construction output has increased in each year since 2002. Construction employment has grown substantially and was close to 250,000 persons at the end of 2005.

Construction price inflation has varied from 4% to 8% over the same period, while overall construction material price increases were quite low until 2004. The surge in material costs in 2004 was due to a very substantial extent to significant increases in steel prices, for both structural steel and reinforcing bar. These increases put pressure on prices of concrete products that used reinforcing bar as a constituent.

The following chart shows concrete product price increases in comparison to "All Building and Construction" materials and is based on Wholesale Price Index data issued by the CSO.



It can be readily seen that over the period 2000 to 2005, cement, readymix concrete and concrete block prices have lagged "All Building and Construction Materials" (which includes timber and steel) and have also lagged behind tender price increases to a substantial extent.

In summary, the concrete sector has not contributed to any significant extent to house price increases or overall construction price increases.

Input Price Changes

The survey of ICF members shows the following changes to input and selling prices in recent years.

	Average
Increase in Selling Price 2003	**0.05%**
Increase in Selling Price 2004	**1.19%**
Increase in Selling Price 2005	**3.27%**
Input price increases 2003	**0.05%**
Input price increases 2004	**7.63%**
Input price increases 2005	**9.02%**

Input prices have risen substantially faster than selling prices in 2004 and 2005. This difference has been absorbed by the concrete sector through investment in new plant, automating production to a greater extent, and by improving the productivity of plant and staff. The key drivers of input price increases have been labour costs, which have risen at an average rate of 6% per annum in recent years and, since 2004, steel costs. Energy prices have increased in the recent past, and this is showing a strong impact on the transport costs in the industry.

While demand for concrete products has increased in recent years, all indicators show continuing price competition in the sector. There are very limited opportunities to add value to basic products such as stone fill or readymix concrete. The high level of price competition is an attribute of an open market, but it has a significant impact on industry profitability when input costs rise faster than selling prices and scope for productivity gains is limited.

Profitability

The average profit before tax of companies in the concrete industry fell from 7.9% of turnover in 2003 to 6.3% in 2004. There are not yet sufficient results for 2005 to show an industry outcome for that year. Operating profit, i.e. profits before depreciation and directors' emoluments, were 12.8% of turnover in 2004. The reduction in profit margins was offset to some degree by increased turnover, but industry profits, in money terms, were lower in 2004 than 2003.

The financial data also show that capital expenditure in 2004 was 1.5 times the amount of depreciation. Assuming that depreciation is a measure of the life of an asset and that an asset is disposed of once it is fully depreciated, this suggests that some 2/3rds of capital expenditure was in respect of replacing old plant. It can also be deduced that the remaining level of capital expenditure represents an increase in industry capacity of the order of 6.5%. This is broadly in line with the industry survey which, as described in more detail in the full report, shows an overall increase in industry capacity of 24% between 2000 and 2005, or an average of 4.4% per annum. Broadly, industry capacity has increased in line with annual volume demand.

Capacity and Utilisation

In response to recent planning requirements, approximately 1,500 quarries were registered with local authorities in Ireland. However, many in the industry are of the view that the number of quarries that could operate at a commercial scale is of the order of 350 to 400. There are an estimated 300 readymix concrete plants in Ireland, 102 operated by public companies and the balance operated by family firms. There are over 100 Concrete Block Plants with about 1/3rd operated by Public Companies and the remainder operated by family firms.

Capacity utilisation in the sector during 2005 was 87.5% of nominal capacity. However, there are seasonal and regional variations in demand resulting in some firms operating at full capacity for periods during the year. The industry is highly flexible, and in the past has successfully increased capacity to cater for all demand.

There appears to be sufficient processing and extraction plant capacity to cater for expected future needs for the short term. Further investment will be needed if overall demand continues to grow, however, in the past, the industry has been willing to invest as required to meet demand. The key constraints on capacity in the future are more likely to be regulatory and/or planning restrictions on vehicle movements and the level of extraction permitted from quarries, and not the plant, equipment or labour capacity of the concrete industry.

Industry Employment

Employment within the industry has grown substantially in recent years, as shown in the following table:

Full Time Staff Numbers	**2003**	**2004**	**2005**
Professional	914	941	968
Technical	342	405	432
Adminstration	1,234	1,225	1,333
Skilled	2,541	2,757	2,703
Semi-Skilled	2,423	2,599	2,586
Unskilled	3,752	4,059	4,054
Total	11,207	11,986	12,077

In addition, there is a number of part time staff who equate to 374 full time staff, and there are 1,273 outsourced staff, mainly in the transport operations.

Payroll costs per employee have grown by 12% over the period 2003 to 2005, as follows:

	Average Payroll Cost / Employee
2003	**€36,313.97**
2004	**€39,286.79**
2005	**€40,976.86**

Market Segments Served

The end-use sectors for concrete and quarry products are as follows:

Sectoral Analysis of Sales	**2003**	**2004**	**2005**
Public Sector (Offices Housing)	5.4%	6.0%	7.9%
Public Sector (Infrastructure)	30.2%	25.3%	20.6%
Private Sector (Commercial)	21.7%	17.2%	18.5%
Private Sector (Residential)	41.4%	50.1%	51.1%
Agri Sector	1.3%	1.4%	1.9%

1.3 Prospects for the Sector

The Irish economy has shown continued and substantial growth in recent years, with GDP growing by the order of 4.5% - 4.7% per annum over the period 2003 - 2005. It is generally accepted that Ireland will see substantial levels of growth in 2006 and 2007, of the order of 5% - 6% in each of these years. These levels of growth are expected to be driven primarily by strong consumer spending, fuelled by the release of SSIA monies, and reasonably strong export performance. However, it is anticipated that from 2008 onwards, growth in consumer expenditure will moderate, and it is anticipated that export performance will also slow down, primarily due to reduced competitiveness in some segments of Irish industry. Interest rate increases and higher energy costs will also constrain consumer spending.

As a consequence, it is projected that although annual GDP growth should be of the order of 5% to 6% in 2006 and 2007, it will slow to more modest growth levels of the order of 3% to 4% per annum from 2008 onwards. It should be said however, that although these growth rates appear relatively modest compared to our recent performance, they would be regarded as very ambitious forecasts in some of our European neighbours.

The Private Residential Segment

Intra-country comparisons of the levels of new dwelling completions per head of population, which in recent times in Ireland have been greater than 20 units per 1,000 of population, or 3 to 4 times the level of new dwelling activity in other European countries, are of limited validity. Ireland has a very different demographic structure and population growth than other European countries, and any comparison of residential building activity should take these demographic characteristics into account. However, there is some consensus that the natural level of new dwelling completions to meet demographic needs, is of the order of 60,000 new dwelling units per annum. Added to this is the demand for second homes and holiday homes, which, based on previous activity, could be of the order of 5,000 - 10,000 new dwellings per annum. This indicates a requirement in the medium term for the order of 65,000 - 70,000 new dwellings per annum.

This is substantially below the level of completions for 2005 (close to 81,000 dwellings), and substantially below the level of completions being projected by various commentators for 2006 to 2008. Estimates of completions for 2006 have been put at as much as 90,000 units. The analysis provided in the full report shows that housing starts have not been keeping pace with completions in 2006, and therefore housing output, measured by housing completions, will start to decline in the near future.

The overall picture that emerges from the analysis of the housing sector is that whereas housing completions in 2006 may exceed 2005 levels, a slowdown to somewhere under 80,000 new dwellings per annum after 2006 is likely to occur, and the pace of new dwelling construction will abate in the medium term.

Public Sector

Buoyant government revenues suggest ample capability for public spending in our infrastructure, both the social infrastructure and transport infrastructure. However the key issue with the Public Capital Programme (PCP) in recent years has been the inability of the various agencies to spend the monies available to them. The original provision for the PCP in 2005 was €9.87 billion, and the provisional outturn for actual expenditure is €8.56 billion; a shortfall of the order of €1.3 billion. Failure to spend the available budgets has been a feature of the Public Capital Programme for some years now.

In order to provide a basis for improved planning of capital expenditure in Government departments and agencies, the Department of Finance initiated five year rolling multi-annual capital envelopes in 2004. These are intended to provide greater certainty to Government departments of the availability of capital funding in future years.

The table following shows the multi-annual capital envelope for key departments from a building and construction perspective. These departments count for in excess of 80% of the overall public capital programme. It can be seen that the annual average growth in the overall capital envelope over the period 2010 is quite substantial, averaging 11% per annum in real terms over that period.

	2006	2007	2008	2009	2010
Education	684	690	855	850	868
Enterprise, Trade and Employment	475	480	499	530	540
Environment, Heritage & Local Gov	1,987	1,950	1,990	2,210	2,270
Health	647	650	777	830	871
Justice	130	280	198	180	204
Transport	1,969	2,278	2,548	3,559	3,714
Sub-total	***5,892***	***6,328***	***6,867***	***8,159***	***8,467***
Overall Envelope	**6,963**	**7,819**	**8,403**	**9,853**	**10,491**

All figures are €million and are at constant 2006 prices

A new National Development Plan is being prepared and is expected to be released towards the end of 2006. It is anticipated that the new Plan will be based on average economic growth of the order of 4.5% per annum to 2010, and that substantial investment in infrastructure will be planned. Transport 21 was published in November 2005 and it indicated that annual expenditure of up to €3.4 billion will take place in this area alone. It is possible that the expenditure projected in the five-year capital envelopes will be increased in the new National Development Plan.

Private Non-residential Segment

The latest national accounts data for 2005 show strong evidence of a substantial pick-up in non residential construction activity in 2005, continuing into 2006. In the long term, there is expected to be a continued recovery in non-residential construction. The expectation of continued employment growth, and a continued expansion of the services sector of the economy, even at levels lower than seen in recent years, should provide continuous demand over the medium term. Construction activity in the retail sector is expected to remain buoyant, driven by continued expansion of consumer spending.

Aggregate Construction Forecasts

The general expectation is that the construction industry and overall construction output will continue to grow at quite high levels in the period 2006 - 2008, though probably not at the very high rates experienced in 2004 and 2005.

The rapid growth in 2004 and 2005 is attributed to extremely high levels of house building, coupled with a substantial increase in public sector expenditure in the areas of housing and roads infrastructure.

It is expected that the level of private residential construction will moderate in future years, but that the overall market will continue to grow modestly, mainly due to a shift from the private residential sector to non-residential development.

A new National Development Plan is due to be published in the latter part of 2006, and this will provide more information on government infrastructure planning in the period to 2010 and possibly beyond.

In the future the key areas of growth are anticipated as being:

- Roads and public infrastructure; projected investment in these areas is expected to be published in the National Development Plan;
- The commercial sector and retail development is expected to continue to perform quite strongly, though many of the new developments may be in provincial areas, and
- Investment in public sector housing will increase as private sector housing developments slow down. However, it is not anticipated that public sector housing developments will match the reductions in private residential developments.

Future Industry Capacity

The industry survey carried out shows that capacity increases planned and/or committed to, will increase nominal capacity by just 6% for the next year. Given the high level of capacity use at present, it is likely that further expansion of capacity will be required in the short term.

Continued investment in plant, equipment, technical capability and increased capacity has been a feature of the industry in recent years and given the likely future increase in demand, it is therefore reasonable to assume that such investment will continue to take place.

This leads us to conclude that the industry will have more than sufficient capacity to meet any increased requirements projected under the new National Development Plan.

Industry Constraints

The potential constraints on industry capacity are as follows:

- The availability of capital to develop the new capacity, arising from the relatively low levels of profitability recorded in recent years.
- The potential curtailment of quarry operations which could restrict the availability of the basic raw materials. This potential constraint arises from the planning process currently being developed in respect of quarries.
- The availability of staff, particularly in the area of transport.

The capacity and performance of the concrete sector could be enhanced as follows:

- Closer co-operation and better planning between contractors and concrete suppliers to ensure the availability of products and optimum response to requests for product delivery.
- Greater certainty in relation to the requirements of the planning system and its impact on quarry operations and greater certainty that, subject to operators conforming to planning conditions, a continuation of operations will be guaranteed.

Issues Facing the Concrete Industry

- ***Industry Profitability***

There are substantial concerns at the level of profitability within the industry at present. As is shown in the full report, price increases in the industry have not kept pace with overall construction price increases over the period 2000 to 2005. The impact of low price increases on industry profitability has been reduced through developments such as:

- Increased levels of automation,
- Improved labour productivity, and
- Outsourcing of some activities, such as transport.

A key concern of the industry is its ability to fund the development of new reserves of aggregate and stone, as well as generating the capital needed to invest in new plant and equipment. There is a strong perception that current price levels do not provide a return that is sufficient to meet future capital needs.

- ***New Entrants to the Industry***

It is generally perceived that one of the key drivers of reduced selling prices has been the expansion in capacity within the industry, not only from existing companies, but from a range of new entrants, who have generally sought to develop market share through price discounting. New entrants are often attracted to an industry which is showing rapid growth, a factor very much in evidence in the concrete products sector over the past six years.

In addition to this new capacity, there are substantial imports of prefabricated concrete products from continental Europe. These are estimated at something of the order of €30 million for 2005, at import price levels, which would be broadly similar to factory gate prices from Irish producers.

In summary, the rapid expansion in building and construction activity in Ireland over the past six years, has led to a sizeable increase in industry capacity, not only from existing players, but also from new entrants, who have in turn driven prices to low levels.

- ***Fixed Price Contracts***

There is substantial concern in the industry over plans, particularly in the public sector, for increased use of fixed price contracts. This is of concern to the sector, because the industry is facing substantial increases in costs in the short term, many of which they cannot control. For example, the recent national wage agreement; energy price increases and the new environmental regulatory structure, particularly in respect of carbon emissions will impact on the price of concrete products and cement.

It is inevitable therefore that the increased use of fixed price contracts being proposed is of concern, given the substantial input price pressures the industry is facing.

- ***Scope for Innovation***

There is a concern within the industry that some bodies outside of the industry criticise it for a perceived lack of innovation in recent years. However, the industry view is that:

- The level of production activity in the industry has been so substantial in recent years, that finding the resources, mainly staff and time, to carry out substantial research and development into innovative building products and solutions has been very difficult, and
- There is a perception that the concrete industry's contribution to industry benefits such as more efficient site working is not recognised in many quarters.

- ***Whole of Life Costing***

A further concern of the concrete industry is that specifiers tend to compare concrete product prices on the basis of the initial acquisition price, and not on a whole-of-life costing basis. In many situations, concrete loses out to alternative materials that have inferior whole-of-life costs. For example, a recent study in Great Britain concluded that concrete motorway barriers were more cost effective in the long run than barriers made from other materials.

This whole-of-life costing is an issue that the industry believes should be addressed by the Federation when developing its future marketing programmes.

- ***Succession in the Industry***

A key concern for many members of the industry is succession within the industry itself. There is a concern that the concrete products and quarrying industry is not attractive to many family members and that in some cases, in family companies, long term succession is of concern.

Reference has been made previously to the potential for consolidation in the sector, if industry circumstances continue as at present, it is considered that the absence of succession could be a further factor bringing about such an industry consolidation.

- ***The Regulatory Impact of Local Government***

There industry has two concerns in respect of the regulatory aspect of local Government involvement in the sector.

The first is what is widely regarded as ineffective planning enforcement by local authorities, particularly on unauthorised quarries. It is reported by industry participants that local authorities are slow to react to complaints; fail to take sufficient action and, in general, through a passive attitude to planning enforcement, allow substantial unregulated activity to take place.

The second issue in relation to planning enforcement is how local authorities will deal with applications for planning approval for new quarry developments, and in particular the type of development levies that may be imposed. The key issue in this regard in the industry is one of dissatisfaction with the current level of uncertainty, rather than on what the regulatory environment may be.

1.4 Issues Facing the Industry

There are five key messages for the concrete industry. They are:

- It is very unlikely that the competitive environment will change or will become any easier in the future. However, on an individual company basis, failure to consider future capital investment needs when determining product selling prices is likely to produce a situation where companies cannot add new capacity in plant, machinery or reserves.
- Extraction from quarries is going to be more difficult in the future. Planning conditions are likely to demand that the industry has to be more responsible; will have to be local resident sensitive and will have to be more environmentally friendly. The industry will have to be even more professional.

- It is very likely that industry capacity will have to increase to meet future demand; particularly if the new National Development Plan is aggressive in its approach to infrastructural development.
- More innovation in the potential uses of concrete and the development of technical solutions will be required. The use of improved standards in product specification should be promoted. There should also be a focus on process development to seek to ensure that concrete's competitive basis vis-à-vis alternative materials is retained.
- Succession in the industry is an issue referred to by some. Normally such an issue tends to lead to a degree of consolidation in the sector. In that case, a significant factor in company valuations is likely to be its reserves base.

Essentially the leading companies will be those that adapt best to the new environment.

1.5 Proposed Strategy

A six element strategy is proposed for the industry which is:

1. Seek to raise the technical qualities demanded by specifiers and make it more difficult for new entrants to the marketplace. Competition is sufficient in the industry at present to ensure that buyers receive competitive prices and service.
2. Ensure the required industry capacity is available; otherwise market share may be lost to alternative materials.
3. Adapt to the new regulatory environment and recognise the related costs in product pricing.
4. Seek clarity and certainty of the future regulatory environment, especially the new planning requirements. Seek consistency in the overall approach across the country.
5. Consider the long term needs of the industry in particular and the nation in general, especially in long term considerations such as the provision of adequate reserves.

6. Demand greater levels of enforcement on the part of the agencies responsible and seek higher levels of regulatory compliance – both by the industry and by others.

1.6 The Role of the ICF

The role of the Federation in the execution of the proposed strategy may be defined as follows:

- A Marketing and Communications role to promote the sector and its members. In particular, a revised approach to promoting the sector and its products might be considered. The concept of "whole-of-life" costing may be a worthwhile avenue to pursue and its application may require amended tender approaches by buyers and specifiers.
- Continue to represent the interests of the membership in various government and industry groups, and seek to promote responsible national regulation and legislation.
- Maintain its training and education role, providing relevant training in a range of aspects such as health & safety and other emerging requirements.
- In short, maintain the current level of advisory, regulatory and technical services to the membership, and maintain the current levels of involvement with the members.