

OMNICELL/SURGICHEM MERGER INQUIRY

Summary of provisional findings report

Notified: 11 July 2014

Background

1. On 14 March 2014, the Office of Fair Trading (OFT) referred the anticipated acquisition by Omnicell, Inc (Omnicell)/MTS Medication Technologies, Inc (MTS) of SurgiChem Limited (SurgiChem) to the Competition Commission (CC) for investigation and report. On 1 April 2014, the CC joined with the competition function, and certain consumer functions of the OFT, to form the Competition and Markets Authority (CMA) which continued with this inquiry. The CMA must decide:
 - (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.
2. This document sets out the provisional findings of our inquiry based on the evidence we have reviewed and the analysis we have carried out to date.
3. Omnicell/MTS and SurgiChem (together referred to below as ‘the parties’) currently overlap in the supply of adherence packaging, accessories and support products for adherence packaging (such as labels, spare seals and ring binders). Adherence packaging products are used by pharmacists to repackage a patient’s medicines, in order to help patients to take the correct dosages at the correct time.
4. The parties also overlap in the market for the supply of trolleys and cabinets used for storage of adherence packaging and potentially overlap in the supply of automated filling machines for single-dose blister adherence packaging.
5. We provisionally concluded that: the anticipated acquisition of SurgiChem by Omnicell/MTS would result in the enterprises conducted by the two parties ceasing to be distinct; and, the merger would result in an increased share of supply of greater than one-quarter for adherence packaging in the UK by

value. The CMA therefore has jurisdiction to consider whether the creation of that situation has resulted or may be expected to result in an SLC within any market or markets in the UK for goods or services.

6. We considered the situation that would have prevailed absent the anticipated acquisition (the counterfactual). We have concluded that, absent the merger, Omnicell/MTS and SurgiChem would continue to compete independently (whether SurgiChem is owned by Bupa or another person). We have also found that it is likely that, absent the merger, SurgiChem would have introduced a new automated filling machine and begun offering card-based adherence packaging to pharmacies thereby increasing customer choice in both areas of the market. Accordingly, the counterfactual includes both of these likely developments.
7. We concluded that the relevant markets within which to assess the competitive effects of the merger are:
 - (a) The market for the supply of disposable adherence packaging, related accessories and support products. This includes both disposable card-based adherence packaging products (as supplied by Omnicell/MTS) and disposable plastic-based adherence packaging products (as supplied by SurgiChem). It includes both the single-dose products usually used for patients in care homes and multidose products usually used for domiciliary patients. It also includes semi-disposable systems, and systems suitable for liquids. It excludes plastic pouches (an alternative to card-based and plastic-based adherence packaging more commonly used in mainland Europe). It also excludes reusable adherence packaging.
 - (b) The market for storage facilities, such as trolleys and cabinets.
 - (c) The market for automated filling machines for single-dose packaging.
8. We found the relevant geographic market for the assessment of the merger to be the UK.

Competitive effects

Nature of competition pre-merger in adherence packaging

9. Pharmacists, with the exception of those purchasing multidose packaging through the NHS Scotland framework agreement, must meet the cost of the adherence packaging that they buy themselves. There are a number of factors that pharmacists may consider when making their buying decisions, including: price, the quality of the product, ease of filling and checking the packaging, security of supply and the level of service from the supplier. We

have found that there are some differences in the weight that different types of pharmacist put on these factors.

10. We have identified three large customers that buy adherence packaging through tenders, with the prices that these customers pay set during the tender process. Other pharmacists tend to buy adherence packaging either through a wholesaler, a buying group or, most often, directly from an adherence packaging supplier. We found that some non-tender customers pay a list price, while other customers negotiate different levels of discounts from the list price.
11. We found that barriers to switching in the market are low. We found that tender customers are relatively price sensitive. Among non-tender customers we found that, while some customers are price sensitive, low levels of switching in this segment of the market suggests that many others do not appear to be. Adherence packaging typically accounts for a small proportion of purchases by pharmacists so the incentives for them to actively engage with this market are often limited. Many pharmacists have little knowledge of alternative products and their prices, which reduces the extent to which they have responded or would respond to price increases or put pressure on their current supplier to reduce prices.
12. We opted to assess competitive effects in three segments of the market:
 - (a) adherence packaging procured through formal competitive tenders;
 - (b) non-tender procurement of adherence packaging for care homes; and
 - (c) non-tender procurement of adherence packaging for domiciliary users.

Assessment of competitive effects of the merger on the adherence packaging market

13. We found that SurgiChem does not currently compete in the tender segment of the market, nor, in our judgement, is it likely to become a competitive constraint on Omnicell/MTS within a reasonable period. As a result, we did not think that the merger would lead to a reduction in competitive rivalry in this segment.
14. We identified some evidence to suggest that the parties are not competing across the entire non-tender segment of the market as closely as their market shares might suggest. The two products are differentiated – being made, in part, from different material. We identified some differences in the sizes of customers that the parties have been successful in winning. There are also differences in the way that the parties structure their supply chains and in their

routes to market. Further, evidence from our survey, questionnaires and third party hearings indicated that a significant proportion of non-tender customers did not consider the parties to be competing closely – in particular, a significant proportion have a strong preference for either a card-based or a plastic-based product.

15. Nevertheless, we found that the parties do compete closely for a significant proportion of non-tender customers, and that there is potential for the anticipated merger to lessen competition for these customers. Responses to our survey, questionnaires and third party hearings identified a significant proportion of non-tender customers who consider the parties to be competing closely. References in the parties' internal documents also suggest that they consider each other to be close competitors, at least for some non-tender customers. Further, SurgiChem's recent development of a card-based product suggests that it intends to compete with Omnicell/MTS for non-tender customers that currently use card-based adherence packaging.
16. We considered the strength of other competitors to the parties in the non-tender domiciliary segment. We found that Venalink, an established player with an incentive to grow its market share in the non-tender segment of the market, would act as a credible competitive constraint on the merged entity in this segment. We also found that Shantys had emerged as another credible constraint, although we note that Shantys' current marketing approach, selling through wholesalers, may not currently enable it easily to reach customers that prefer to buy their adherence packaging directly from a supplier. We considered that there is some doubt as to whether pouch-based systems are a significant competitive constraint, given the upfront expense for the pharmacy in putting in place the system. However, we also note that a small number of pharmacies that use adherence packaging more frequently consider that the solution is cost-effective overall. We have, therefore, found that there are at least two competitors to the parties in the domiciliary segment of the market that would constitute significant competitive constraints on the merged entity.
17. We considered the strength of competitors other than the parties in the non-tender care-homes segment of the market. We considered that Venalink, for the reasons discussed above, was a credible competitive constraint on the merged entity in the care homes segment of the market. Manrex is also an established long-term competitor in this segment of the market. While, its product is only available to pharmacists, other than Boots, through one wholesaler, this has not prevented Manrex from establishing a significant share of the care-home segment. We also considered the competitive constraint offered by Protomed, which has grown very successfully in recent years. The product is significantly more expensive than the parties' products

on a per-pack basis, although we also note that as a multidose product it could be used in place of more than one of the parties' single-dose products in a care-home context. We concluded that Protomed may have a limited constraint on the merged entity's prices. We considered that, in the same way as in the non-tender domiciliary segment, there is uncertainty over whether pouches could be a credible constraint in the non-tender care-home sector. We therefore identified three established rivals to the parties in the care homes segment of the market. Two are likely to be significant competitive constraints, whereas the likelihood of Protomed constraining the parties' prices is lower.

18. We found that there had been a number of examples of recent entry and that barriers to entry and expansion were fairly low. The most significant barrier is to persuade customers, some of whom we have found not to be particularly engaged, to switch to a new supplier. We also noted that if the merging parties were to attempt to increase their prices materially following the merger, this barrier might be reduced as we would expect there to be a greater willingness among customers to switch suppliers in such circumstances.
19. We considered whether entry and/or expansion would be likely to act as a timely, likely and sufficient constraint on the merged entity. We found that entry, particularly from overseas suppliers, could be achieved on a timely basis, as could the expansion of an existing player. We found that there was a reasonably high likelihood of entry and/or expansion into the market, based on both the recent history of entry and expansion in the market and on our findings on the intentions of Dexapack to enter the UK market in 2014 and the stated intention of a number of existing suppliers to expand. We considered whether any of the firms that have the intention to enter or expand are likely to become a sufficient additional constraint within a reasonable time period. We found that there is a material likelihood that at least one would and that the collective impact of their attempts may also act as a constraint on the parties.

Provisional conclusion on competitive effects of the merger in the adherence packaging market

20. We found that SurgiChem and Omnicell/MTS compete closely for a significant proportion of non-tender customers and that the merger could therefore lead to a reduction in competitive rivalry. However, we found that there are existing players in the market that will offer significant constraints on the merged entity in both the non-tender care-home and non-tender domiciliary segments of the market. Our findings on the potential for entry and expansion provide us with

additional indications that the parties could be constrained further within a reasonable period. Taken together this evidence on existing constraints and further potential for entry and expansion leads us provisionally to conclude that the merger is unlikely to result in an SLC in the adherence packaging market.

Provisional conclusion on competitive effects of the merger in the automated adherence packaging filling machines market

21. We considered the extent to which the merger was likely to affect significantly the outcomes for customers in the market for automated adherence packaging filling machines.
22. We found that Omnicell/MTS's single-dose automated filling machine and the one that SurgiChem has developed are different in terms of cost and speed, with SurgiChem's machine likely to be significantly more expensive and faster than the Omnicell/MTS's machine. This indicates that there are unlikely to be many circumstances in which the two products could both fulfil a particular customer's requirements. We have also found that, in circumstances where customers could choose between the two machines, there are a number of other automated or semi-automated solutions for filling adherence packaging available. We have found that these include bespoke machines that are available from other suppliers (eg Ilseemann, Uhlman, TEG), and pouch-based systems. These other providers are likely to provide a sufficient competitive constraint on the parties in terms of semi-automated or automated solutions to pharmacies in the UK.
23. We also note that the machine is still a prototype and that it has not been possible to estimate the future levels of demand for the machine. Further, there is only a small pool of potential customers for whom the parties could compete.
24. On this basis, we have provisionally concluded that the merger is unlikely to result in an SLC in the market for automated filling machines.

Provisional conclusion on competitive effects of the merger in the market for trolleys and cabinets for storage of adherence packaging

25. We considered whether the merger was likely to affect significantly outcomes for customers of trolleys and cabinets for storage of adherence packaging. We found that a significant reduction in competition in the supply of trolleys and cabinets is unlikely as a result of the proposed merger. There is little overlap between the parties in the supply of trolleys and cabinets. While SurgiChem is active in this market, it appears to be a minor area for

Omnicell/MTS. Furthermore, we have identified a number of other credible competing suppliers of trolleys and cabinets in the marketplace which could constrain the merged entity.

Provisional conclusion on the SLC test

26. Based on the above, we provisionally concluded that the proposed merger is not expected to give rise to an SLC in (a) the market for the supply of adherence packaging in the UK; (b) the market for the supply of automated adherence packaging filling machines in the UK; or (c) the market for the supply of trolleys and cabinets for the storage of adherence packaging in the UK.