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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: LM055Jul16

In the matter between:

Clicks Retailers (Pty) Ltd — Primary Acquiring Firm

and

The retail pharmacy business carried on by Netcare Pharmacies 2 (Pty) Ltd within Medicross Clinics

The front shops of the in-house retail pharmacies operated by Netcare Pharmacies (Pty) Ltd within Netcare Hospitals — Primary Target Firms

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Panel	: Norman Manoim (Presiding Member)
	: Yasmin Carrim (Tribunal Member)
	: Medi Mokuena (Tribunal Member)
Heard on	: 10 November 2016
Order Issued on	: 10 November 2016
Reasons Issued on	: 9 December 2016

Reasons for Decision

Approval

[1] On 10 November 2016, the Competition Tribunal ("Tribunal") conditionally approved the merger between Clicks Retailers (Pty) Ltd ("**Clicks**") and two target firms.[1] The first of which is described as "The retail pharmacy business carried on by Netcare

[1] Conditions attached hereto marked Annexure A.

Pharmacies 2 (Pty) Ltd within Medicross Clinics" which we will refer to as the "**Medicross Pharmacies**". The second, described as "The front shops of the in-house retail pharmacies operated by Netcare Pharmacies (Pty) Ltd within Netcare Hospitals" which will be referred to as the "**Front-shops**". For ease of reference the Medicross Pharmacies and Front-shops components of the transactions will be dealt with separately.

[2] While the hearing was initially anticipated to be heard on a contested basis, the merging parties, the Minister of the Economic Development Department ("**The Minister**") and the Commission settled all outstanding disputes prior to the commencement of the hearing. The reasons for our approval of the proposed transaction follow.

Parties to transaction

Primary acquiring firm

[3] The primary acquiring firm Clicks, is ultimately owned and controlled by Clicks Group Limited ("**Clicks Group**") which is a public company listed on the JSE Limited. The Clicks Group controls a number of subsidiaries but relevant to this transaction are the following two wholly-owned subsidiaries; United Pharmaceutical Distributors ("**UPD**") and Unicorn Pharmaceuticals (Pty) Ltd ("**Unicorn**").

[4] Clicks, which forms part of the retail offering of the Clicks Group, has a number of retail outlets which sell consumables ranging from beauty products, toiletries and personal care. From the number of Clicks stores that the Clicks Group owns approximately 385 of these have retail pharmacies as well. UPD holds a wholesale pharmacy license and operates as a pharmaceutical wholesaler and distributor to Clicks retail stores as well as a number of private hospitals and independent pharmacies. Unicorn is a generic pharmaceutical products marketer which supplies Clicks retail stores with generic medication which it sources from contracted third party manufacturers.

Primary target firm

[5] The target firms are Medicross Pharmacies and Front-shops which have as their overarching controller Netcare Limited ("**Netcare**") which is a public company listed on the JSE and not controlled by any one shareholder.

[6] Netcare operates a private hospital network in South Africa as well as institutional and retail pharmacies at such hospitals.[2] In addition, Netcare owns various retail pharmacies in some of its Medicross Centers.

Proposed transaction and rationale

[7] The proposed transaction involves two components, the first is the purchase of Medicross Pharmacies and the second is the purchase of Front-shops.

[8] Click's acquisition of the Front-shops is an acquisition of only the retail component of in-hospital pharmacies. To clarify, this is an acquisition of the retail space and business which sells consumables such as soap or perfume or schedule 0 medications such as paracetamol or ancillary medical items such as bandages.[3] It is an acquisition of the business which sells products which are generally found at the front of a pharmacy store. It is not an acquisition of the pharmacy business, the behind-the-counter space and business which dispenses Schedule 1 and higher medications.[4] The pharmacy businesses of Netcare hospitals will continue to remain under Netcare's ownership and will not result in the transfer of any pharmacy license from Netcare to Clicks. Branding at the Netcare pharmacies will make it apparent to the consumer that the pharmacies are still owned and controlled by Netcare. Competition concerns, as they relate to this acquisition, will be dealt with under the section Front-shop transaction.

[9] The acquisition of Medicross Pharmacies will result in Clicks acquiring both the Front-shop and retail pharmacy components of the Medicross Pharmacies which will also result in Clicks acquiring the licenses of these pharmacies. Competition concerns as they relate to Medicross pharmacies will be dealt with under the section Medicross Pharmacies Transaction.

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[2] Legislation requires that all hospitals have Institutional pharmacies which would be responsible for the provision of medication to patients at the hospital. Institutional pharmacies are also required to be controlled by the controller of that hospital. Retail pharmacies, on the other hand, is an optional additional service offering provided at some hospitals. Retail pharmacies at hospitals, in addition to dispensing medication, would sell various consumables at the front of the shop such as soap, bandages and perfume.

[3] Schedule 0 medications are medications which do not require a retailer to hold a pharmaceutical licence for its sale.

[4] Medications which are Schedule 1 and higher require the seller to hold a valid pharmaceutical licence.

[10] In addition to the acquisitions above, Clicks will enter into lease agreements with Netcare for the premises of the Medicross Pharmacies and Front-shop areas within the Netcare in-hospital pharmacies.[5]

[11] Netcare, referencing the sale of the Front-shops submitted that that the proposed transaction would offer consumers more choice through an enhanced retail/front shop offering. In reference to the sale of Medicross pharmacies, Medicross submitted that the proposed sale would be to the benefit of consumers as it would result in lower dispensing fees and better script accessibility. Clicks submitted that the proposed transaction would complement its existing business.

Impact on competition

[12] According to the Competition Commission's ("the Commission") findings the proposed transaction raised a number of concerns which could be resolved through its proposed conditions. The merging parties initially contested the relevance of certain conditions, which will be dealt with in detail below. However, the merging parties and the Commission had at the commencement of the hearing come to an agreement on a set of conditions addressing the Commission's concerns. In addition, the merging parties undertook to include in their conditions certain undertakings which formed part of its negotiations with the Minister which will be addressed under the Public interest section.

[13] It is necessary at this juncture to mention that the market shares calculated by the merging parties and by the Commission differed significantly. As the concerns addressed by the Commission were settled by agreement, an agreement which we find addresses any potential concerns, it is not necessary for us to make a finding on the veracity of either.

Front-shop transaction

[14] The Commission evaluated this transaction in the market for the retail of Schedule 0 medications and front- shops. In so far as a horizontal overlap is concerned it found that the merged entity would also compete with non-specialized retail outlets and

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5 The rental fee to be paid for renting the front-shop areas and Medicross centres was the subject of contention for the merging parties and the Commission as the amount to be paid is to be calculated using the stores turnover which the Commission feared allowed for the exchange of competitively sensitive information. This issue is dealt with below under the heading coordinated effects.

would continue to be constrained post-merger by retailers such as large supermarkets and small independent stores.

[15] A number of concerns were raised by us at the hearing which are dealt with below.

[16] One such concern was the overlap in relation to the provision of Schedule 0 medications such as paracetamol as both the Netcare pharmacy and the Clicks front-shop supplies these products. In this regard it was established that the overlap will only be prevalent where a doctor's script would prescribe a schedule 0 medication. The merging parties submitted that if the script required more than 20 of an unscheduled medication it would be provided for by the pharmacist who would charge a dispensing fee but if it were under 10 it could be taken from the shelf. The consumer is also under no obligation to fill their full script at the pharmacy and may elect to purchase the Schedule 0 medications from the front-shop. This is also not a significant concern as the prevalence of this overlap is very limited.

[17] Another concern raised, in relation to Clicks becoming aware of its competitor, Netcare's dispensing fees as both would share the same premises was addressed by the merging parties in the conditions. They undertook to keep this information and other competitively sensitive information secret which addressed our concerns in this regard.[6]

[18] We find that the Front-shop transaction will not result in a substantial lessening or prevention of competition.

Medicross transaction

[19] The Commission primarily found that Clicks and Medicross Pharmacies are not close competitors as Clicks has a larger product range and an expansive geographic footprint as it is located at many shopping centers whereas Medicross serves a convenience function as it is located at Medicross centers in close proximity to doctors' rooms. As such Medicross is not considered to act as a competitive constraint to retail pharmacies. This evidence was further corroborated by market participants during the Commission's investigation. Even on a conservative approach it found that the merged entity would face a number of competing pharmacies within a 5 kilometer radius of every Medicross pharmacy.

[6] See item 2.4 of the conditions contained in our order dated 10 November 2016.

[20] The merged entity would also be constrained from raising prices of scheduled medications due to the following:

- All scheduled pharmaceutical products supplied to the private sector is subject to Single Exit Price ("SEP") regulations
- Dispensing fees charged by pharmacies are capped according to regulation. This is also constrained further as Medical Aid Schemes negotiate or in some instances have the power to set the dispensing fees which will apply to its scheme members.
- Logistics fees are capped according to regulation.

[21] The supply of Schedule 0 products and front-shop products at Medicross Pharmacies is similarly of no concern and would face the same competitive constraints as those mentioned above in relation to the Front-shop transaction.

[22] The merging parties also submitted that the Medicross transaction would be welfare enhancing as the Medicross Pharmacies would benefit from Click's wider product range, it's pricing as well as its promotions.

[23] We concur with the Commission that the Medicross transaction would not result in a substantial lessening or prevention of competition.

Co-ordinated effects

[24] The Commission identified that a potential for co-ordination was created as a result of clauses in the respective lease agreements for the target businesses as they relate to the calculation of rental. According to the clause, rental for the premises of the front-shops and Medicross centers would be calculated using the nett monthly turnover of the target businesses. The calculation of turnover entitled Medicross and Netcare to inspect Clicks account books, records and other data relating to the calculation of the net monthly turnover and for Clicks to provide Medicross and Netcare with any other information or explanations as required. The concern that Netcare and Medicross would be provided with disaggregated information relating to specific dispensing fees is mitigated by the condition imposed and agreed to by the merging parties in our order.[7] The condition stipulates that independent auditors would be appointed and would have

[7] See item 2 of the conditions contained in our order dated 10 November 2016.

access to any information required to determine the nett monthly turnover and that this information would not be provided to Netcare or Medicross. We find that this condition addresses the concerns raised by the Commission.

[25] Another concern was a clause in the sale agreements affording Click's the right of first refusal for any new Medicross and front-shop areas opened for a duration of ten years with an option to renew the clause for a further ten years. The merging parties submitted that the right of first refusal is in order for Clicks to protect its investment and to ensure brand consistency at Medicross centers. The Commission was of the view that the rationale submitted by the merging parties does not outweigh the harm of restricting third parties from operating the target businesses and is further exacerbated by the long duration of the clauses. The Commission recommended that the merging parties reduce the period to three years from the approval date. At the hearing, the merging parties undertook to do so.[8] We are of the view that the agreed condition mitigates concerns raised by the Commission.

Vertical effects

[26] The Commission identified two vertical effects but found that neither resulted in any potential concerns. The first related to the Clicks wholly-owned subsidiary UPD, where the Commission evaluated whether the proposed transaction would result in input and customer foreclosure in the markets for the wholesale distribution of pharmaceutical and front-shop products. The Commission found that UPD did not have the ability to engage in input foreclosure as there are a number of competing wholesales which carried higher percentages of the total market share. In relation to customer foreclosure, the Commission, evaluating whether the merged entity would have the ability to foreclose other wholesalers from supplying Medicross pharmacies found that a majority of Medicross Pharmacies are serviced by Netcare's in-house distribution function. In addition, it found that Medicross Pharmacies accounted for less than 5 percent in the retail market for pharmaceutical products and no other wholesalers were reliant on Medicross Pharmacies as customers.

[27] The second related to the wholly-owned subsidiary Unicorn where the Commission investigated whether it would result in input or customer foreclosure in the market for the manufacture and supply of pharmaceutical products. The Commission found that Unicorn holds a negligible market share of less than 1 percent and only supplies Clicks

[8] See item 3 of the conditions contained in our order dated 10 November 2016.

stores and so would not result in input foreclosure. The proposed transaction would also not result in customer foreclosure even though the merging parties intend to supply the target businesses with Unicorn-branded products as the majority of products sold at the target businesses is sourced from an in-house distributor and no other wholesalers are reliant on the target businesses.

[28] As neither vertical overlaps were concerning further ventilations at the hearing were unnecessary as we do not find anything to the contrary.

Public interest

Employment

[29] The merging parties submitted that the proposed transaction would result in the relocation of eight employees to the acquiring firms operations. The merging parties submitted that the transfer of these employees will be on the same terms and conditions as their current employment. The Commission did not find that this to be a concern and therefore did not recommend imposing any conditions in this regard.

[30] The Commission engaged with relevant trade unions and the Minister who raised a concern that the proposed transaction may result in potential retrenchments. In order to assuage these concerns the merging parties undertook not to retrench employees as a result of this transaction for a period of 5 years after implementation.[9]

Local Procurement and training

[31] The Minister raised concerns over the potential impact this transaction may have on the public interest. The Minister elected not to make submissions to the Tribunal on the basis of certain undertakings made by the merging parties which are contained in the conditions. The first relating to local procurement, is a condition requiring the merging parties to use reasonable endeavors to maintain its local procurement levels.[10] The second relating to training, is a condition requiring the merging parties to provide 100 learnership opportunities and 80 to 100 bursaries in pharmacy over the course of 5 years. At the hearing it was clarified that the beneficiaries of a bursary may also qualify for the learnership.[11]

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[9] See item 4 of the conditions attached to our order dated 10 November 2016.
[10] See item 5 of the conditions attached to our order dated 10 November 2016.
[11] See item 6 of the conditions attached to our order dated 10 November 2016.

[32] The Commission, noting that it had not received a copy of these undertakings well in advance of the hearing, submitted that it did not go into an assessment on the applicability of these conditions but did not object to their inclusion in the conditions.

[33] As the parties consent to the inclusion of these conditions they are contained as undertakings in our order.

Conclusion

[34] In light of the above, we conclude that the proposed transaction is unlikely to substantially prevent or lessen competition in any relevant market. In addition, public interest issues, as they relate to employment, which may arise from the proposed transaction would be mitigated by the conditions contained in our order. Accordingly, we approve the proposed transaction conditionally.

Mr Norman Manoim | 09 December 2016 **DATE**

Ms Yasmin Carrim and Ms Medi Mokuena concurring

Tribunal Researcher:	Aneesa Ravat
For the merging parties:	Anthony Norton and Anton Roets of Nortons Inc
For the Commission:	Anisa Kessery, Portia Bele and Hilda Maringa