

***Case No IV/M.1143 -
DSM / KONINKLIJKE
GIST-BROCADES***

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**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 07/05/1998

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 07.05.1998

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sirs,

Subject: Case No IV/M.1143 - DSM/Gist Brocades

Notification of 01.04.1998 pursuant to Article 4 of Council Regulation N/4064/89

1. On 16.03.1998 the Commission received a notification of a proposed concentration pursuant to Article 4 of a Council Regulation (EEC) No. 4064/89 by which DSM N.V. (DSM) acquires within the meaning of Article 3(1)(b) of the Council Regulation control of Koninklijke Gist-Brocades N.V. (GB) by way of a public bid. The notification was declared incomplete and completed on 01.04.1998.
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation No 4064/89 and does not raise serious doubts as to its compatibility with the common market and with the functioning of the EEA Agreement.

I. THE PARTIES' ACTIVITIES AND THE OPERATION

3. DSM N.V. is the ultimate holding of the DSM group which is active in energy, polymers, resins and plastic products and industrial and fine chemicals.
4. GB is active in fine chemicals and biotechnology based on fermentation and enzyme processes.
5. With the public bid DSM intends to acquire 100 % of the share capital of GB.

II. CONCENTRATION

6. With the notified transaction DSM will acquire control over GB.

III. COMMUNITY DIMENSION

7. DSM and GB have a combined aggregate worldwide turnover in excess of 5,000 million ECU (DSM: 5.569 million ECU; 1.018 million ECU). Each of them has a Community-wide turnover in excess of 250 million ECU, but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension, but does not constitute a cooperation case under the EEA Agreement, pursuant to Article 57 of that Agreement.

IV. ASSESSMENT.

8. In view of the complementarity of the activities of GB and DSM, there is no horizontal overlap between the markets in which each party is present. The notified transaction only presents vertical and conglomerate aspects in the area of the manufacture and sale of bulk antibiotics and their intermediates. These constitute the only markets affected by the notified transaction.

PRODUCT MARKETS.

9. There are two kinds of antibiotics in which the parties are active or for which they sell intermediates necessary for the production of those antibiotics: semi-synthetic penicillins (SSPs) and semi-synthetic cephalosporins (SSCs).

GB is a leading producer of penicillins, penicillin-derived antibiotics and other anti-infectives in the world. It produces in particular the following products:

Penicillin raw materials. PenV and PenG, which are essential raw materials for the production of 6 APA and 7 ADCA, which are intermediate products for the production of respectively SSPs and SSCs.

6 APA and 7 ADCA.

SSPs and SSCs.

A number of other penicilline based antibiotics and other antibiotics for which the intermediates produced by DSM are not used.

10. DSM produces, sells and markets side chain products. Side chains is a generic term for certain carbohydrate derived chemical structures. DSM produces seven side chains products, four of which are merely derivatives of the three base side chains:

PGCH and Danfenil are derivatives of PG (together the "PG line").

Danoxi is a derivative of PHPG (the PHPG line).

Danhydro is a derivative of DHPG (the DHPG line).

11. Derivatives differ from the base chain of the relevant line because they are already processed in order to integrate with the relevant intermediate (6 ACA or 7 ADCA) according to the production process used by a producer of SSCs or SSPs. The conversion process of base chains into derivatives is not complex. It is old and widely known, and there are no significant barriers or costs involved in setting up an own conversion process.
12. In the absence of any horizontal overlap, the notified transaction could only raise serious doubts about its compatibility with the common market if the combination of GB's and DSM's respective intermediates would create or reinforce a dominant position in the market for the end product, this is, SSCs and SSPs.
13. The parties had already entered into a 50/50 joint venture (CHEMFERM), which produces bulk SSCs. GB supplies the JV with 7 ADCA and DSM supplies it with side chains. The impact of the notified transaction is therefore limited in the area of SSCs.

GEOGRAPHIC MARKETS.

14. Penicillins and cephalosporins are well established antibiotics for which patents have expired and there is a well developed competition from generics. They are widely used throughout the world. Production takes place according to US or British pharmacopoeia specifications, which have been accepted as uniform standards.
15. The products affected by the notified transaction are intermediates and bulk antibiotics sold to pharmaceutical firms worldwide for their subsequent dosage and formulation. They are of a relative high value and transport costs are negligible (less than 2% of production costs for side chains. For the other relevant products prices are quoted inclusive of transport costs, regardless of destination). Most players active in these markets, including the parties themselves, manufacture their products from a limited number of sites throughout the world. Sales forces are limited to a handful of persons.
16. According to the notification, prices for all the affected products are fairly homogeneous the world over. This is confirmed by a study of the antibiotics industry carried out by an independent consultant, analyzing price trends by reference to a worldwide price quoted in dollars
17. Finally, the customers contacted by the Commission during its investigation have confirmed that they are able to source intermediates bulk antibiotics worldwide.
18. The geographic market can therefore be considered to be worldwide for the purposes of analyzing the present case.

MARKET SHARES.

19. The parties have submitted estimates of their own market shares and those of competitors on the basis of non-captive sales. Given the importance of the production by the large multinational pharmaceutical firms, which are in many instances substantially or completely vertically integrated, the proportion that non-

captive sales represent of the total market is also indicated. The respective market shares of the parties and their competitors are estimated as follows for 1997¹:

Raw penicillin : (non-captive 25%)	GB	[40-50]%
	Synpac	[20-30]%
	Hoechst	[10-20]%
	NPC	[10-20]%
6 APA (non captive 10%)	GB	[70-80]%
7 ADCA (non-captive 40%)	GB	[60-70]%
Bulk SSPs (non-captive 42%)	GB	[30-40]%
	Antibioticos	[30-40]%
	Biochemie	[20-30]%
	Kopran	[0-10]%
	BMS	[0-10]%
Bulk SScs (non-captive 72%)	Chemferm	[20-30]%
	Dobfar	[20-30]%
	Orchid	[10-20]%
	Antibioticos	[10-20]%

Side chains:

PG line	DSM	[50-60]%
PHPG line	DSM	[60-70]%
DHPG line	DSM	[80-90]%

COMPETITIVE FORCES.

20. There are numerous companies active in the manufacture and sale of penicillin based antibiotics and cephalosporins. There are very different degrees of vertical integration, which is dictated to a large extent by the differences in the optimal scale of operation at each step of the vertical chain. For instance, small producers of bulk antibiotics (i.e. below 50 tonnes per year) customarily purchase their intermediates. Once bulk output exceeds 100 tonnes per year, there may be an opportunity to integrate upstream into the manufacture of the appropriate intermediate (6 ACA or 7ADCA).
- 21 A first group of competitors is composed of the fully integrated pharmaceutical firms, which manufacture most of their requirements of intermediates and are also integrated into the sale of dosage antibiotics. This would include Smith Kline Beecham, Bristol Meyers Squibb, Elli Lilly, Novartis generics, Pfizer, etc... Broadly speaking, these companies market and sell pharmaceutical specialties, in competition with generic manufacturers.

¹ For the public version, the market share figures have replaced by ranges.

22. A second tier of companies is composed of companies such as GB or Antibióticos, which are integrated from the fermentation of penicillin through to the supply of bulk active ingredient.
23. Other companies, such as Dobfar, Kopran and Teva are significant players not involved into the fermentation process, but which manufacture downstream products.
24. In the absence of any horizontal overlap arising from the notified operation, competitive concerns could only arise if the transaction would foreclose the access of other players to any of the intermediates, in particular with regard to the side chains produced by DSM, given its high shares in those markets.
25. The Commission has verified with clients/competitors whether they consider that they have a sufficient number of alternative suppliers in the situation post-merger, in particular for side chains.
26. Generally, non integrated clients/competitors of the parties have indicated that they consider to have a number of alternative suppliers of side chains, which they have used in the past in some cases. These alternative suppliers are Recordati (Italy), Kaneka (Japan), China Camphor (Taiwan) and Chirex (UK).
27. Furthermore, the general situation with regard to side chains, raw penicillin, 6 ACA and 7 ADCA and bulk SSPs and SSCs is characterized by significant excess capacity worldwide.
28. Given that the downstream markets (i.e. bulk antibiotics and dosage forms) are competitive, any restriction on the availability of intermediates would probably result in (a) companies purchasing those intermediates would integrate upstream or (b) companies purchasing those intermediates would disappear from the market to the advantage of vertically integrated companies. In either case, any restriction imposed by the merged entity on the availability of intermediates for which it has a high market share would only result in a loss of clients and outlets for its production, to the advantage of its vertically integrated competitors. The presence of integrated firms would ensure that the market structure would remain competitive even if a number of smaller competitors would disappear.
29. In this respect, it has to be noted that the creation of the joint venture between GB and DSM in 1996 for SSCs has not resulted in a restriction of the availability of intermediates or in a substantial change of the conditions of competition in that market. Chemferm has a market share of [10-20]% of the total cephalosporins market and of [20-30]% of the non-captive market, the market leader being Dobfar with a share of [20-30]% of the non-captive market.

V. CONCLUSION

30. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the

functioning of the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation No 4064/89.

For the Commission,