

Part II

Background and evidence

3 The companies involved, their activities and financial performance

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Introduction

3.1. This chapter describes briefly the businesses of the parties and provides information about the history and financial performance of each. It ends with a description of the terms of the merger and subsequent developments.

3.2. The businesses of the parties consist in the provision of sales and marketing information mainly to the pharmaceutical industry but also to other healthcare manufacturers and providers.

3.3. In most industries, particularly in the fast-moving consumer goods (FMCG) category, the manufacturers themselves are closely involved in detailed measurement of sales and in directly targeting their customers, albeit often with outside assistance. In many sectors, sales data are collected by intermediaries such as Nielsen (see paragraph 3.8) which then process and analyse the data for clients. In such cases, measuring sales through point-of-sale scanning equipment and the setting up of consumer panels, focus groups, shopping surveys and the like is relatively straightforward.

3.4. In the prescription pharmaceutical industry, the ultimate purchasing decision-taker is predominantly the prescriber, usually a GP, who is not the consumer. The consumer, in the form of the patient, may redeem his prescription in a locality quite different from that in which it was issued. Furthermore, the identity of the patient is protected in the UK by confidentiality requirements. Patients therefore cannot be targeted by manufacturers, even to the extent that a ban exists on the public advertising of prescription drugs. The pharmaceutical distribution chain is therefore not straightforward, and so market research companies tend to be specialized. Further details of these services are contained in Chapter 4.

The parties

3.5. IMS and PMSI are both incorporated in the USA and their shares are traded on the New York Stock Exchange and NASDAQ respectively.¹ As described in paragraphs 3.100 and 3.101, IMS completed the acquisition of all of PMSI's non-US assets (except those in Belgium on which it had a three-month option) in August 1998 so that PMSI is now active only in the USA.

3.6. The recent histories of both IMS and PMSI involve numerous acquisitions, divestments and demergers which are described below and summarized by way of notes and schematic diagrams in Appendices 3.1 to 3.3.

3.7. The market capitalization of IMS on 14 January 1999 was US\$11.5 billion (£7 billion).

IMS

History

3.8. IMS provides market research, sales management, professional software, direct marketing and research and development (R&D) services to the pharmaceutical industry worldwide. In 1988 it was acquired by D&B, a provider and processor of financial and other data. In January 1996 D&B announced demerger plans (to be effected by stock dividends) whereby it and its subsidiaries would be reorganized within three separate corporations: Cognizant, to hold IMS, Nielsen Media, D&B's 51 per cent holding in Gartner Group, Inc (Gartner) and some small subsidiaries not relevant to this inquiry; the 'new' D&B to consist of the original D&B business, Moody's Investors' Service and Reuben H Donnelley; and A C Nielsen Inc since renamed ACNielsen Inc (Nielsen). Cognizant's market capitalization as at 31 January 1997 (the latest practicable date before its US accounting return Form 10-K was filed) was approximately US\$5.5 billion (£3.6 billion).

3.9. IMS was the only part of the D&B group specializing in the pharmaceutical sector for ethical drugs. Other parts of the group which might be regarded as operating in related sectors were Nielsen which provides market research data particularly to the FMCG sector, and Gartner which provides research and analysis services to the IT sector mostly on a continuous subscription basis.

¹On 15 December 1998 Quintiles announced an agreed bid for PMSI at \$197 million expected to be completed in the first quarter of 1999. Included in PMSI's balance sheet is \$90 million in cash.

3.10. Cognizant was demerged by D&B and floated as a separate holding company on 1 November 1996. On 15 January 1998 Cognizant announced its own plans to become two independent companies, comprising predominantly IMS (including the Gartner stake) and Nielsen Media respectively. This duly took place on 30 June 1998.

3.11. On 23 March 1998 Cognizant and Walsh announced an agreed bid by IMS for Walsh. This was completed on 23 June for a consideration of US\$193 million (£117 million). Walsh is primarily a provider of ETMS systems, particularly in the pharmaceutical field, and its acquisition has not given rise to objections by the Office of Fair Trading or other competition authorities.

3.12. Walsh had been established in 1988 and in 1991 it had demerged PMSI by way of initial public offering (IPO). Subsequent events involving PMSI are described in paragraphs 3.50 to 3.56; further information on Walsh is given in paragraphs 3.40 to 3.49.

3.13. On 8 January 1999 IMS's UK interests comprised its own operations, Walsh and PMSI (including Source UK).¹

Activities

3.14. In the UK, PMSI provides services covering, *inter alia*, sales measurement, micromarketing and physician profiling to the pharmaceutical industry. Its *Source Dispenser* product is used by some clients for sales territory management. IMS provides services covering, *inter alia*, market research, sales measurement, micromarketing and sales territory management. Some of these services, particularly in the sales measurement and physician profiling areas, are syndicated in that the same information (or derivatives of it) is sold to several clients, usually on a subscription basis for a minimum of one year. Such business is characterized by high fixed overheads and less significant marginal costs. IMS and PMSI both sell the following services upon which we comment in detail in paragraphs 3.15 to 3.19.

TABLE 3.1 Combined sales of IMS and PMSI common services

	<i>Combined sales* £m</i>
OTC audits of non-prescription items	2.0
Prescription audits	1.1
Micromarketing	<u>1.7</u>
Total	4.8

Source: IMS.

*Year ended 30 June 1998.

3.15. OTC audits monitor product movements. IMS has a monthly service called *OTC Report* which extrapolates sample data of product movements into retail outlets to sales data at national, regional and territory levels. It also has a service that monitors movements of both OTC and general healthcare products out of retail outlets extrapolated to national level. Buyers of these services receive data on all manufacturers' products.

3.16. PMSI has *OTC Adviser* which provides weekly data on the purchasing company's own products analysed by pharmacy outlet which is useful for monitoring promotional campaigns and for micromarketing activity, ie targeting individual pharmacies. The respective OTC products of IMS and PMSI are therefore somewhat different.

3.17. Prescription audits measure drug movements out of pharmacies at a national level. IMS has *Xtrend* which projects movements from a sample of independent and multiple pharmacies to national level. PMSI has *Prescription Audit* which measures national volumes and values of products dispensed

¹Indirectly, IMS also had an interest in Gartner's UK operation but that is not related to the pharmaceutical industry.

through retail pharmacies, and *Prescriber Regional Tracker* which contains unprojected data that indicate where individual products, including form and pack details, were prescribed during a reporting period.

3.18. Micromarketing services relate to the measurement of prescription data at local levels. We were told that such services were relatively new in the UK and are perceived by the pharmaceutical industry as highly significant in enabling manufacturers to target their sales efforts accurately. PMSI collects data from about 30 per cent of pharmacies to provide its *Micromarketer* service. This provides data on volumes and values prescribed by groups of doctors aggregated by geographical location.

3.19. Other products offered by IMS include:

- (a) *British Pharmaceutical Index (BPI)*, which is an audit of sales and other supplies made to retail pharmacies. Data are provided at national, regional, territorial and sub-territorial levels. The data are collected through the BAPW and other suppliers and delivered six to eight weeks later;
- (b) *Mediplus* and *Medical Data Index (MDI)* provide extrapolated data derived from a panel of 500 GPs covering consultations, diagnosis and treatment. Data are downloaded directly from the GPs' computer systems. A similar service, *PCMD*,¹ covers ancillary items such as dressings and other consumables;
- (c) *Hospital Pharmacy Audit* and *Hospital Pharmacy Audit Index*, which are services estimating the national consumption of pharmaceutical products in hospitals utilizing about 90 per cent of available hospital data. A derivative, *DMD*,² provides a different view of the same data; and
- (d) other products including veterinary audits, promotional audits and STRs. The latter reflect sales movements into retail pharmacies and are used by pharmaceutical companies to monitor the effectiveness of their sales teams. IMS also has a 50 per cent interest in Medicare Limited which develops and sells hospital audits.

3.20. Further details of products and markets are in Chapter 4.

3.21. IMS provides information services covering 94 countries from offices in 74 countries. Its products are provided on a national level within any single country from databases that have been built up locally over a period of several years. These information services can also be viewed through an international viewing system called MIDAS which allows clients to view IMS national audits from different countries at once and, in some instances, third party or client internal data. This information is provided by a Global Services Division which is based in London with other offices elsewhere and which services the headquarters of pharmaceutical companies around the world.

3.22. The volumes of data involved are large and require appropriate handling and processing to put them into usable form. Data can be provided in an edited form to clients, or to their third party nominees for manipulation or analysis, or it can be delivered as a finished service from one of IMS's own databases. Delivery can be effected by any electronic means including on-line access to a database such as MAXIMS for *BPI* data in the UK. IMS operates central data processing facilities in Germany, England, the USA and Japan.

¹*Patient Care Medical Data.*

²*Disease Management Data.*

Financial aspects

Group

3.23. IMS's performance worldwide is summarized in Table 3.2.

TABLE 3.2 IMS: profit and loss account summary

	Years ended 31 December				£'000
					Nine months ended
	1994	1995	1996	1997	30 September 1998
Sales	<u>652,518</u>	<u>801,215</u>	<u>891,974</u>	<u>639,702</u>	<u>478,842</u>
Operating profit/(loss)	95,220	43,208	154,040	137,418	(13,826)
Non-operating income/(expense)	<u>6,787</u>	<u>(1,217)</u>	<u>(1,432)</u>	<u>50,961</u>	<u>54,356</u>
Profit before interest	102,007	41,991	152,609	188,379	40,530
Net interest received	<u>5,574</u>	<u>6,253</u>	<u>5,131</u>	<u>6,313</u>	<u>9,253</u>
Profit before tax—continuing operations	107,581	48,244	157,740	194,691	49,783
Tax	<u>43,463</u>	<u>21,866</u>	<u>69,405</u>	<u>53,346</u>	<u>30,014</u>
Profit after tax—continuing operations	64,119	26,378	88,334	141,346	19,769
Profit after tax—discontinued operations	<u>31,883</u>	<u>30,424</u>	<u>35,204</u>	<u>47,233</u>	<u>25,351</u>
Retained earnings	96,001	56,803	123,539	188,579	45,120
Stated diluted earnings per share (p)	56	33	73	112	26

Source: IMS/MMC analysis and translation.

Notes:

1. Average translation rates have been used based on those prevailing at June and December in each year.
2. Gartner was deconsolidated from IMS in 1997. The effect was to reduce 1997 sales by approximately £300 million and to increase non-operating income by £34 million (1998 nine months: £27 million).
3. Non-operating income in 1998 comprised Gartner income (note 2), profits on sales of subsidiaries and gains arising from share sales by subsidiaries.
4. The above figures do not include other comprehensive income recorded by IMS such as currency translation gains and losses and unrealized gains and losses on investments.

3.24. The table shows relatively modest increases in sales (allowing for the removal of Gartner's £300 million in 1997) but significant increases in both profit before interest and diluted earnings per share (EPS) between 1995 and 1997. The deconsolidation of Gartner in 1997 was caused by IMS's shareholding being diluted to below 50 per cent. Plans to demerge Gartner were announced in November 1998 with completion expected early in 1999. Figures for discontinued operations in each year are for Nielsen Media (demerged in June 1998).

3.25. The operating profit for the nine months ended 30 September 1998 was adversely affected by costs relating to the Nielsen Media demerger of £21 million and by year 2000 compliance costs of a further £21 million. There were also write-offs of acquired in-process R&D costs relating to the acquisitions of Walsh and PMSI amounting to £40 million and direct acquisition and integration costs of a further £29 million, making a total of £111 million of exceptional items. IMS reported that in its underlying business (ie excluding acquisitions and disposals during the year) there had been a profit improvement of 45 per cent for the nine-month period. This profit improvement outpaced revenue growth of 15.9 per cent primarily because of the disposal of Pilot, which was loss-making, on 31 July 1997.

3.26. Direct acquisition and integration costs included abandonment of some IMS products under development, redundancies in both IMS and PMSI and closure of some IMS facilities.

3.27. The balance sheet impact of the acquisitions of Walsh and PMSI are referred to in paragraphs 3.30 and 3.31.

3.28. Table 3.3 analyses IMS's sales by main subsidiary group and by region.

TABLE 3.3 **IMS: analysis of sales**

£ million

	Years ended 31 December		
	1995	1996	1997
<i>Sales and operating profit by company</i>			
IMS:			
Sales	534	572	592
Operating profit	57	147	160
Profit margin (%)	11	26	27
Gartner:			
Sales	216	268	Not consolidated
Operating profit	33	38	
Profit margin (%)	15	14	
Emerging markets:			
Sales	51	52	48
Operating (loss)	(12)	(8)	(6)
Profit margin (%)	<u>(23)</u>	<u>(16)</u>	<u>(12)</u>
Total sales	<u>801</u>	<u>892</u>	<u>640</u>
<i>Sales by region</i>			
USA	354	405	247
UK	45	52	26
All other	<u>402</u>	<u>435</u>	<u>367</u>
Total	<u>801</u>	<u>892</u>	<u>640</u>
UK percentage of total	5.6	5.9	4.1

Source: IMS/MMC analysis.

3.29. The table shows that the UK element, which excludes the Global Services operation, represents only about 4 per cent of IMS's worldwide business. 'Emerging markets' includes subsidiaries Erisco, CTS, Super Systems Japan and Pilot (sold in July 1997) which provide a variety of software services that are not relevant to our inquiry.

3.30. Table 3.4 shows balance sheet summaries.

TABLE 3.4 **IMS: balance sheet summaries**

£'000

	As at 31 December				As at 30 September 1998
	1994	1995	1996	1997	
<i>Fixed assets:</i>					
Tangible	229,795	206,227	197,011	167,324	210,348
Goodwill	160,389	149,947	151,068	52,678	197,607
Investments	<u>136,655</u>	<u>116,640</u>	<u>110,728</u>	<u>231,618</u>	<u>62,811</u>
	526,840	472,814	458,808	451,620	470,766
<i>Net current assets/(liabilities) excluding cash</i>					
	<u>(122,146)</u>	<u>(80,375)</u>	<u>(16,643)</u>	<u>25,790</u>	<u>(3,257)</u>
Operating assets	404,694	392,439	442,164	477,410	467,509
Net cash	81,980	101,539	254,078	188,252	186,884
Provisions	<u>(82,816)</u>	<u>(80,425)</u>	<u>(117,610)</u>	<u>(121,721)</u>	<u>(125,515)</u>
Net assets	<u>403,858</u>	<u>413,553</u>	<u>578,632</u>	<u>543,941</u>	<u>528,878</u>
<i>Shareholders' funds:</i>					
Share capital	0	0	484,701	488,197	481,280
Reserves	388,896	392,641	(154)	(221,213)	(337,376)
Retained earnings	0	0	39,640	215,976	316,257
Minorities	<u>14,962</u>	<u>20,912</u>	<u>54,445</u>	<u>60,980</u>	<u>68,716</u>
Total shareholders' funds	<u>403,858</u>	<u>413,553</u>	<u>578,632</u>	<u>543,941</u>	<u>528,878</u>

Source: IMS/MMC analysis and translation.

3.31. The table shows IMS to be generally liquid with net cash at 30 September 1998 of £187 million representing 35 per cent of net assets subject to the needs of future developments. Prior to 1996 when IMS was a subsidiary of D&B, it had divisional equity which did not appear on its balance sheet as share capital. This was converted to share capital when Cognizant (with IMS) was

demerged from D&B. The reduction in reserves in 1997 was due to the acquisition of IMS's own shares on the open market and held as treasury stock and to a significant movement in the cumulative translation adjustment. In 1998 there was a reduction in fixed assets of US\$123 million (£74 million) caused by the demerger of Nielsen Media and an increase in goodwill of US\$249 million (£150 million) arising from the acquisitions of Walsh and PMSI, among other movements. Provisions comprised deferred employee benefit liabilities, provisions for deferred tax and other liabilities. The impact of the acquisitions is summarized in Table 3.5.

TABLE 3.5 **Acquisitions of Walsh and PMSI: goodwill calculation**

	£'000		
	<i>PMSI</i>	<i>Walsh</i>	<i>Total</i>
In-process R&D write-off	8,552	31,318	39,870
Net liabilities assumed	(17,028)	(3,017)	(20,045)
Other intangibles, net of deferred tax	1,268	7,739	9,007
Goodwill	<u>69,417</u>	<u>80,647</u>	<u>150,064</u>
Total purchase price	62,209	116,688	178,896

Source: IMS/MMC translation.

3.32. In-process R&D costs are identifiable intangible assets which IMS wrote off on acquisition. Net liabilities assumed were the negative book net asset values of each business at the time of acquisition and goodwill is the difference between the net assets and liabilities acquired and the price paid. The goodwill is to be written off over 15 years.

3.33. IMS told us that it had based the consideration for the acquisition of PMSI on several factors but predominantly on the basis that it would have a neutral impact on earnings (before non-recurring write-offs) in the first year and would enhance earnings thereafter based on projected income. Third party advisers had been engaged to analyse market factors including prices of recent public transactions within the healthcare information services sector.

UK

3.34. IMS's UK financial performance is summarized in Table 3.6. The figures are a consolidation of IMS UK, two subsidiaries of which are vehicles for IMS's Global Services operation which also operates through IMS AG.

TABLE 3.6 **IMS UK: consolidated summary of financial performance**

	£'000				
	<i>Years ended 30 November</i>				
	<i>Actual</i>				<i>Forecast</i>
	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>
Sales	<u>34,595</u>	<u>38,587</u>	<u>37,590</u>	<u>36,219</u>	<u>39,896</u>
Operating profit/(loss)	2,136	3,292	2,630	215	(3,420)
Non-operating income/(expense)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(169)</u>
Profit/(loss) before interest	2,136	3,292	2,630	215	(3,589)
Net interest (paid)	<u>(617)</u>	<u>(324)</u>	<u>(133)</u>	<u>(529)</u>	<u>(806)</u>
Profit/(loss) before tax	1,519	2,968	2,497	(314)	(4,395)
Tax/(credit)	<u>778</u>	<u>(122)</u>	<u>620</u>	<u>(195)</u>	<u>(557)</u>
Profit/(loss) after tax	741	3,090	1,877	(119)	(3,838)
Dividends	-	-	126	756	-
Retained earnings/(loss)	<u>741</u>	<u>3,090</u>	<u>1,751</u>	<u>(875)</u>	<u>(3,838)</u>
Shareholders' equity	(5,693)	(2,603)	(269)	(1,144)	N/A

Source: IMS/MMC analysis.

3.35. The table shows sales declining to £36.2 million in 1997 before increasing to £39.9 million in 1998. However, profitability declined between 1995 and 1998 from a pre-tax profit of £3.0 million to a forecast pre-tax loss of £4.4 million. The reasons are given in paragraph 3.36. IMS provided us

with pro forma management figures for the UK on a stand-alone basis, ie excluding the Global Services contributions. These figures are set out in Table 3.7 and show the impact of apportioning the cost of group services which IMS does not charge to operating subsidiaries but carries as a corporate overhead.

TABLE 3.7 IMS: UK stand-alone pro forma operating profit

	Years ended 30 November				
	£'000				
	Actual			Forecast	
	1994	1995	1996	1997	1998
Sales					
Operating costs:					
Data payments					
Salary costs					
Other local costs					
Processing and production					
Total operating costs					
Operating income per IMS management accounts					
Uncharged group services:					
Corporate finance, tax, treasury					
Millennium compliance					
European business management					
Employee share option cost					
Total group service apportionment					
Operating income/(loss) fully loaded					
Underlying business margin on sales (%)					
Development costs capitalized					
Amortization of development costs					
Net capitalized development costs					

Figures omitted.
See note on page iv.

Source: IMS/MMC translation and analysis.

3.36. The table shows 1998 sales at the same level as in 1995 whilst data payments and salary costs have risen substantially. Operating income fully loaded is after deducting apportioned group costs (referred to in paragraph 3.35). IMS told us that the sales reduction in 1997 had been caused by the introduction of Sunrise pricing¹ (described in paragraph 4.30) whilst in 1998 attempts had been made to redress matters. Increased data collection costs were the consequence of data providers realizing the value of their information and increasing prices as well as the development of *Xtrend* requiring more data to be collected. Increased staff costs were caused by a decision to improve client relationships which required more client service staff. The trend has been a deterioration since 1996 into a loss on a fully loaded basis.

3.37. Capitalized development costs are those which have been incurred in a particular year and carried forward for writing off (amortized) against expected future income of the related product. The capitalized costs and amortization figures shown relate largely to the development of *Xtrend* and the net capitalized figures are the net increase in capitalized costs each year (ie capitalized costs less amortization).

3.38. Figures relating to the two UK subsidiaries which account for part of Global Services are included in the consolidated figures in Table 3.6 but not in the management data in Table 3.7. Global Services business is also booked in IMS AG which is registered in Switzerland and has a UK branch. Table 3.8 summarizes the results of Global Services both within the UK subsidiaries and within the UK branch of IMS AG. Global Services are not restricted to the UK but represent business on a worldwide basis.

¹Sunrise is the name given by IMS to a new and complex method of pricing based more on actual lines of data sold to a client rather than by product based on numbers of sales staff.

TABLE 3.8 IMS: Global Services showing contributions to UK consolidated figures

	£'000			
	1994	1995	1996	1997
Sales:				
IMSWorld Publications Ltd				
Pharma Strategy Group Ltd				
Total included in UK consolidation				
IMS AG UK branch				
Total Global Services				
Operating profit/(loss):				
IMSWorld Publications Ltd				
Pharma Strategy Group Ltd				
Total included in UK consolidation				
IMS AG UK branch				
Total Global Services				

*Figures omitted.
See note on page iv.*

Source: IMS.

3.39. The table shows that sales and profitability increased rapidly until 1996 but in 1997 sales remained flat and profits declined (by 3.6 per cent).

Walsh

History

3.40. Walsh was established in 1988, was floated in 1996 and its stock was traded on NASDAQ until its acquisition by IMS in June 1998. In 1991 it demerged PMSI (see paragraphs 3.12 and 3.50) and in 1996 it demerged Source (see paragraph 3.80).

Activities

3.41. Walsh's business was the provision to the pharmaceutical industry worldwide of ETMS systems, in which it claims to be a market leader, and sales management information systems. Its two products covering these fields are called *Precise* (an established DOS-based system) and *Premiere* (a newer system based on Windows). They enable sales representatives to plan calls, log call reports, analyse their calling activity, track sales and promotions and to exchange information with other sales forces and teams within the client. Management can thereby monitor and direct field activity, analyse calling and promotional activity and compare performances of representatives or sales forces. Such facilities are typically installed under an initial two- or three-year contract and continued on an evergreen basis whereby annual renewal is automatic unless terminated.

3.42. Walsh also provides databases of medical professionals, in some markets extending to pharmacists and administrators, under the name *Pharbase*. This is available either for use with third party ETMS software or embedded in *Precise* or *Premiere* thereby providing clients with a marketing database included within the management system. It is supplied on a country by country basis. Three-quarters of *Precise* and *Premiere* clients take *Pharbase* but other databases can also be utilized. The *Pharbase* database is updated from several sources including clients, PMSI and Source. Walsh also provides a direct mail service utilizing its *Pharbase* database. In the UK and three other countries mailing facilities are also provided.

3.43. Walsh and Source entered into a Preferred Technology Agreement in 1996 whereby they agreed to collaborate to build and maintain a seamless data interface between their respective technologies to facilitate delivery, via *Premiere*, of prescription data at the sales representative level.

3.44. As at 30 June 1997, Walsh was active in the USA, Canada, Europe, Australia and New Zealand and had implemented *Precise* for 440 sales forces (1996: 380) and *Premiere* for 50 sales forces. *Pharbase* was used by 350 sales forces. At that time, *Pharbase* was licensed to Source on a non-exclusive basis for internal use in certain countries in connection with the development, delivery and marketing of its prescriber-linked prescription databases.

UK

3.45. Walsh's operations in the UK have consisted of a local operating subsidiary, Walsh UK, responsible for collecting and processing data and marketing the group's products.

Financial performance

Group

3.46. Table 3.9 summarizes Walsh's recent financial performance.

TABLE 3.9 Walsh: financial summary

	£'000				
	Years ended 30 June				Nine months ended 31 March 1998
	1994	1995	1996	1997	
Sales	<u>22,892</u>	<u>25,816</u>	<u>30,319</u>	<u>33,449</u>	<u>27,628</u>
Operating profit/(loss)	(4,141)	(610)	2,458	3,574	2,448
Non-operating income/(expense)	<u>2,249</u>	<u>1,014</u>	<u>0</u>	<u>0</u>	<u>(257)</u>
Profit/(loss) before interest	(1,891)	404	2,458	3,574	2,191
Net interest received/(paid)	<u>(1,028)</u>	<u>(881)</u>	<u>(771)</u>	<u>328</u>	<u>147</u>
Profit/(loss) before tax—continuing operations	(2,919)	(478)	1,687	3,902	2,338
Tax	<u>1,000</u>	<u>1,418</u>	<u>422</u>	<u>952</u>	<u>1,002</u>
Profit/(loss) after tax—continuing operations	(3,920)	(1,896)	1,265	2,950	1,336
Loss after tax—discontinued operations	(3,845)	(996)	(1,126)	0	0
Minority interests	<u>0</u>	<u>0</u>	<u>72</u>	<u>12</u>	<u>(74)</u>
Retained earnings/(loss)	<u>(7,765)</u>	<u>(2,892)</u>	<u>212</u>	<u>2,962</u>	<u>1,262</u>
Stated earnings/(loss) per share (p)	(54)	(26)	16	28	28
Shareholders' equity	N/A	(24,355)	3,044	5,950	7,984

Source: Walsh/MMC analysis and translation.

3.47. The table shows Walsh as a consistently expanding business both in terms of sales and profitability, including profitability after non-operating items, until 1998 when, on a pro rata basis, the operating profit margin fell by about 9 per cent. The increase in shareholders' funds in 1996 was caused partly by the IPO in that year which raised US\$33.6 million (£21.8 million).

UK

3.48. Table 3.10 summarizes Walsh UK's profitability.

TABLE 3.10 Walsh UK: financial summary

	£'000			
	18 months ended 30 June 1994	Years ended 30 June		
	1994	1995	1996	1997
Sales	<u>14,054</u>	<u>9,531</u>	<u>10,254</u>	<u>10,424</u>
Operating profit	<u>1,852</u>	<u>843</u>	<u>1,607</u>	<u>2,192</u>
Net interest paid	<u>(462)</u>	<u>(397)</u>	<u>(282)</u>	<u>(177)</u>
Profit before tax	<u>1,390</u>	<u>446</u>	<u>1,325</u>	<u>2,015</u>
Tax	<u>663</u>	<u>399</u>	<u>225</u>	<u>659</u>
Net profit after tax	<u>727</u>	<u>47</u>	<u>1,100</u>	<u>1,356</u>
Shareholders' funds	142	916	2,016	3,372

Source: Walsh UK/MMC analysis.

3.49. The table shows Walsh UK as developing well after 1995. A comparison with the Walsh group (see Table 3.9) shows that, whilst sales have not increased as rapidly, in 1997 it contributed some 60 per cent of group operating profits from 30 per cent of group sales.

PMSI

History

3.50. PMSI was formed in 1991 by Walsh which demerged it in the same year (see Appendices 3.1 and 3.2) by way of an IPO which raised US\$49 million (£33 million) for PMSI. Immediately following the demerger and IPO, Walsh held approximately 58 per cent of PMSI. As part of the demerger, Walsh licensed to PMSI on a long-term exclusive basis two of its proprietary databases relating to prescriber profiles and which formed the backbone to the PMSI business. There were also various other agreements covering data processing, administrative services and sub-leasing of various facilities. In some cases, PMSI was the provider to Walsh.

3.51. In 1996 Walsh demerged Source, to which it assigned the PMSI licence agreements. By 1994, Source had begun building a prescription database in several European countries. IMS subsequently began building its own. From 1996, Source and PMSI worked closely together and shared the same Chairman, Mr Handel Evans, and Chief Executive Officer, Mr Dennis Turner. Mr Turner was also the non-executive Chairman of Walsh. Notwithstanding the links at senior levels, the companies' objectives were different and varied from country to country.

3.52. In December 1997 PMSI concluded a three-way deal with Source and NDC (by which we refer to the National Data Corporation group, and its subsidiary NDC Health Informatics Services (Arizona) Inc which gave evidence to us) whereby:

- (a) it sold to NDC (i) its approximately 26 per cent share in a US joint venture with Source (Source US) and (ii) its OTC physician database business in the USA; and
- (b) it acquired all of Source's European operations which had been moved into Source Informatics European Holdings LLC (Source Europe).

At the same time NDC acquired Source, the remaining business of which was its US operation. IMS told us that this gave NDC access to Source's US software and the Source Europe software which Source had built with Source Europe's input. NDC agreed not to compete with Source Europe within Europe and Source Europe agreed not to compete with NDC in the USA. This non-compete agreement lapsed on IMS's acquisition of PMSI's non-US business including Source Europe in August 1998.

3.53. Source Europe embraced operations in the UK, France, Germany, Italy, Belgium and the Netherlands. They were set up to develop prescription databases and information databases similar to those based on Source's *Alpha* database in the USA and to which PMSI had licensed access.

3.54. Further information on NDC is given in paragraphs 3.92 to 3.96.

3.55. The pre-tax gain to PMSI as a result of the transaction was US\$33.6 million (£20.2 million) before selling expenses and the consideration paid for Source Europe was US\$8.4 million (£5.0 million).

3.56. Following completion of the three-way deal, PMSI consisted of Scott-Levin in the USA, Source Europe and other operations in Europe and Japan. The main PMSI businesses in the UK and elsewhere in Europe were each direct subsidiaries of PMSI Holdings Ltd, a Delaware holding company, and the Source businesses were each subsidiaries of Source Informatics Europe LLC,

another Delaware holding company within the PMSI group. On 5 August 1998 PMSI sold all its non-US assets to IMS, except for four subsidiaries in Belgium (see paragraphs 3.99 to 3.102), for a price of US\$75 million (£45 million).¹ Following this transaction, PMSI's main operating subsidiary was Scott-Levin in the USA. Within the IMS group, the Source and PMSI operating companies in the UK (and in other countries) became separate subsidiaries of IMS.

Activities

3.57. PMSI provided a range of information services, primarily micromarketing, to the pharmaceutical and healthcare companies in Europe and Japan, and market research services in the USA. Most of these services were generated from its own proprietary databases (including those of Source) containing prescription, managed care, healthcare and medical prescriber data. Further details of UK products are contained in paragraphs 3.14 to 3.18, 3.58, 4.39, 4.47 and 4.48, 4.71 to 4.73, 4.75 and 4.76 and 4.91 to 4.99.

UK

3.58. Products offered in the UK, other than those which overlap with IMS (see paragraphs 3.14 to 3.18), include:

- (a) *Generator* and *Moderator*, which are primary market research services based on interviews with medical staff addressing perceptions, behaviour and attitudes;
- (b) *Prospect* and *Scriptrac*, which are prescriber profiling services analysing current product prescribing, trends and choices. The data are collected by self-completed postal questionnaires based on responses from 60 per cent and 40 per cent respectively of UK GPs;
- (c) several other profiling services aimed at measuring the effectiveness of product promotional efforts whether through calls or advertising or both, and an advertising monitoring service; and
- (d) pharmacy management software and various medical directories and maps. These are provided through subsidiaries Medical Research Factors Limited and Mediphase Limited.

3.59. Further details of these products are provided in paragraphs 4.91 to 4.99. PMSI did not have any equivalent product to IMS's Global Services.

Financial performance

Group

3.60. As referred to in paragraph 3.50, PMSI raised US\$49 million (£33 million) at the time of its IPO in December 1991. In May 1992 it raised a further US\$9 million (£6 million) by way of a secondary share offering and in February 1993 it raised a further US\$67 million (£43 million) through an offering of convertible debentures.

3.61. Comparisons of the operating performance of PMSI as between one year and another are somewhat obscured by the frequency of acquisitions and disposals. Table 3.11 shows a summary of PMSI's financial performance.

¹The total cost to IMS after allowing for net liabilities assumed and expenses was \$103 million.

TABLE 3.11 PMSI: financial summary

	Years ended 30 June					£'000
	1994	1995	1996	1997	1998	
	Sales	50,962	57,629	59,677	60,905	47,204
Operating profit/(loss)	3,020	5,283	334	4,653	(18,012)	
Profit before tax—continuing operations	2,870	5,299	250	4,535	3,271	
Profit/(loss) after tax and minority interests	3,132	3,321	(6,174)	(3,249)	(183)	
Stated diluted earnings/(loss) per share (p)	24	26	(47)	(25)	(1)	
Shareholders' funds	49,213	54,674	47,317	38,760	35,201	

Source: PMSI/MMC translation.

3.62. In 1997 PMSI's OTC business and its approximately 26 per cent interest in a joint venture with Source US, which were disposed of in December 1997, reported aggregate revenues of US\$25 million (£15 million) and operating profits of US\$5.9 million (£3.5 million) before apportionment of corporate overheads. The results for 1998 therefore reflect the loss of six months' contributions from those businesses.

3.63. Results for 1998 were also affected by the acquisition of Source Europe which was heavily loss-making. Unaudited pro forma figures showing the trading impact of Source Europe had it been a subsidiary for the whole of the financial years ended in 1997 and 1998 are shown in Table 3.12. Further information on the Source businesses is given in paragraphs 3.80 to 3.91.

TABLE 3.12 Pro forma effect on PMSI of acquiring Source Europe on 30 June 1996

	Years ended 30 June				£'000
	1997		1998		
	Stated	Pro forma	Stated	Pro forma	
Sales	60,905	61,156	47,204	48,134	
Net loss	(3,249)	(16,201)	(183)	(8,568)	
Net loss per share (p)	(25)	(122)	(1)	(67)	

Source: PMSI/MMC translation.

3.64. The table shows the pro forma impact of the acquisition of Source Europe alone on the net loss after tax in the full year ended 30 June 1998 which would have increased by £8.4 million.

3.65. The 1998 results for PMSI's main operating subsidiary in the USA, Scott-Levin, were sales of US\$26 million (£15.7 million) and operating profits of US\$6.6 million (£4.0 million), increases of 21 per cent and 36 per cent respectively on the previous year.

3.66. Overall in 1998 there was a reduction in gross margin of £6.0 million and a reduction in sales, general and administration expenses (SG&A) of only £0.5 million, the effect of which was a fall in operating profits from £5.6 million in the previous year to almost nil.

3.67. At the non-trading level in 1996 and 1997 there were losses on disposals of subsidiary operations of approximately £6 million in each year. In 1998 there was a profit on sale of the US operations of £20.6 million which was significantly offset by an impairment of assets held for sale of £8.9 million and a write-off of goodwill arising from the acquisition of Source Europe of £8.1 million as R&D costs.

3.68. A more detailed version of PMSI's trading results is at Appendix 3.4. Table 3.13 shows a summary of PMSI's balance sheets.

TABLE 3.13 PMSI: balance sheet summaries

	Years ended 30 June					£'000
	1994	1995	1996	1997	1998	
Fixed assets:						
Tangibles	10,472	14,421	33,216	7,151	11,966	
Intangible	36,271	37,224	16,795	15,386	13,366	
Investments	<u>0</u>	<u>1,899</u>	<u>12,009</u>	<u>19,825</u>	<u>11,779</u>	
	46,743	53,543	62,020	42,362	37,111	
Current assets:						
Stock	2,973	2,759	1,937	5,292	902	
Debtors	24,308	29,835	29,807	19,262	18,900	
Total current assets (excluding cash)	27,282	32,594	31,744	24,554	19,802	
Creditors due within one year	<u>28,215</u>	<u>26,880</u>	<u>19,419</u>	<u>20,015</u>	<u>31,087</u>	
Net current assets/(liabilities) excl cash	<u>(934)</u>	<u>5,714</u>	<u>12,325</u>	<u>4,539</u>	<u>(11,286)</u>	
Net operating assets	45,809	59,257	74,345	46,901	25,825	
Net cash/(debt)	4,034	(4,145)	(26,273)	(7,787)	14,077	
Creditors less debtors due after one year	(631)	0	(755)	(354)	(4,702)	
Provisions	<u>0</u>	<u>(438)</u>	<u>0</u>	<u>0</u>	<u>0</u>	
Net assets	<u>49,213</u>	<u>54,674</u>	<u>47,317</u>	<u>38,760</u>	<u>35,201</u>	
Shareholders' funds:						
Share capital	54,534	54,114	56,463	53,090	53,512	
Reserves	0	0	0	0	(5,146)	
Revaluation reserves	447	3,475	438	(2,151)	(848)	
Retained earnings	(6,775)	(3,230)	(9,584)	(12,179)	(12,317)	
Minority interests	<u>1,006</u>	<u>315</u>	<u>0</u>	<u>0</u>	<u>0</u>	
Total equity	<u>49,213</u>	<u>54,674</u>	<u>47,317</u>	<u>38,760</u>	<u>35,201</u>	

Source: PMSI/MMC analysis and translation.

3.69. The changes in the 1997 balance sheet were caused by a reclassification of assets in anticipation of the three-way deal in December 1997. The negative reserves in 1998 were caused by the acquisition of own shares as an asset of Source Europe.

3.70. The summary shows net current liabilities excluding cash and borrowings at 30 June 1998 amounting to £11.3 million and net cash (which includes near-cash) of £14.0 million. Prima facie, that would leave little margin to carry continuing losses. However, fixed asset investments, consisting of marketable securities, amounted to a further £11.8 million. Arguably, therefore, at 30 June 1998 there was surplus net cash available of £14.5 million. The question then arises as to the further cash needs of Source Europe and the timing of it becoming a cash generator in the context of the cash needs of other product developments and the income of Scott-Levin.

PMSI viability

3.71. Paragraphs 3.80 to 3.91 describe the business of Source including Source Europe. Paragraph 3.86 refers to the aggregate losses of Source Europe up to 30 September 1997 of US\$46 million (£29 million). The PMSI shareholders' circular dated 14 November 1997 seeking approval for the three-way deal (see paragraph 3.52) included under the heading 'risk factors' a reference to Source Europe being a 'development stage business' and having incurred losses since its inception. Other statements under risk factors included:

The future profitability of PMSI will depend upon management's ability to successfully implement plans to integrate Source Europe with PMSI's European operations and to increase the revenues of Source Europe.

... the profitability of PMSI ... will be largely dependent upon the ability of the Company to establish and increase Source Europe's service revenue and there can be no assurance that the Company will succeed in doing so.

3.72. The circular went on to refer to management as expecting increasing revenues over future periods without a corresponding increase in costs. Source Europe had 'service supply agreements with over 30 pharmaceutical companies, which, subject to delivery of full data services, should aggregate to more than US\$30 million (£18 million) in revenue over the next four years'. However, this

compared with operating costs of US\$20.9 million (£12.6 million)—production costs US\$7.5 million, SG&A US\$10.1 million and R&D costs of US\$3.3 million for the year ended 30 June 1997.

3.73. Source had obtained US\$10.4 million (£6.5 million) funding from its clients through 'partner client' relationships whereby up to 15 clients would receive future product at a discount or free and on an exclusive basis for a period of two years from product launch in any one country. Some of these advances have since been refunded because of delays in developing the product, whilst other clients are entitled to refunds but have not taken them. Further details of these advances are given in paragraph 4.72.

3.74. Table 3.12 shows the pro forma effects of PMSI acquiring Source Europe as losing £8.4 million in the year ended 30 June 1998 (1997: £13 million). (That was before allowing for the effects of the disposal of the PMSI US operations in the sale to NDC (see paragraph 3.52).)

3.75. Whilst the historical financial record is not one that suggests long-term viability, we received some opinions to the effect that the future UK market size for micromarketing products could be £10 million or more. Nevertheless, PMSI's former Chairman (now with IMS) told us that he and all of the PMSI personnel regretted that PMSI had not been able to continue as an independent company. The evidence is that PMSI with Source Europe was unlikely to have been viable unless additional external funding could have been obtained.

UK

3.76. PMSI operated its UK businesses through PMSI UK which had two subsidiaries. Table 3.14 summarizes the consolidated profit and loss accounts of PMSI UK.

TABLE 3.14 PMSI UK: consolidated profit and loss summaries

	Years ended 30 June				
	1994*	1995	1996	1997	1998
Sales	7,435	8,138	9,431	9,332	8,203
Operating profit/(loss)	1,533	(319)	(1,533)	425	474
Non-operating expense	0	0	(796)	(800)	(394)
Profit/(loss) before interest	1,533	(319)	(2,329)	(375)	80
Net interest received/(paid)	119	54	(296)	(407)	(532)
Profit/(loss) before tax	1,652	(265)	(2,625)	(782)	(452)
Tax/(credit)	590	396	(98)	(155)	7
Profit/(loss) after tax	1,062	(661)	(2,527)	(627)	(459)
Minority interests	-	-	(64)	-	-
Retained earnings/(deficit)	1,062	(661)	(2,463)	(627)	(459)

Source: IMS/MMC analysis.

*18-month period.

3.77. Table 3.14 shows that PMSI UK has generated pre-tax losses since 1994 although losses before tax have reduced since 1996. One of its subsidiaries is Mediphase Limited (Mediphase) which provides management software for pharmacies. A by-product of the stock and pharmacy management functions of this software is the creation of prescription data. In the year ended 30 June 1998, Mediphase generated a pre-tax profit of £516,000 on sales of £2.7 million. The other subsidiary, PMSI Medical Research Factors Limited, generated pre-tax profits of £117,000. Without these contributions, the consolidated loss would have been greater by £633,000. The principal accounting policies in the 1996 and 1997 accounts contained statements to the effect that the accounts had been prepared on a going concern basis on the assumption that the parent company would continue to provide financial support for the company and the group. The 1998 accounts are still being prepared.

3.78. The trading results of Source UK are referred to in paragraphs 3.89 to 3.91. In the year ended 30 June 1998 Source UK lost £4.3 million before tax. Combining this loss with that of PMSI UK (see paragraph 3.76) gives an overall loss of £4.8 million for that year.

3.79. In the absence of firm evidence of sufficient imminent income from the new micromarketing products developed in conjunction with Source Europe, there is nothing to indicate that PMSI UK was a viable stand-alone entity. As referred to in paragraph 3.82, extensive delays in the introduction of these products had occurred. Table 3.15 shows summary balance sheets for PMSI UK.

TABLE 3.15 PMSI UK: consolidated balance sheet summaries

	Years ended 30 June					£'000
	1994	1995	1996	1997	1998	
Fixed assets:						
Tangible	62	401	682	1,001	919	
Intangible	21	156	309	115	0	
	83	557	991	1,116	919	
Current assets:						
Stock	0	21	21	29	47	
Debtors	1,367	2,267	3,600	4,616	2,204	
Total current assets (excluding cash)	1,367	2,288	3,621	4,645	2,251	
Creditors due within one year	2,005	3,267	8,793	10,382	9,831	
Net current liabilities excluding cash	(638)	(979)	(5,172)	(5,737)	(7,580)	
Net operating liabilities	(555)	(422)	(4,181)	(4,621)	(6,661)	
Net cash	3,789	528	1,234	892	1,829	
Net assets/(liabilities)	3,234	106	(2,947)	(3,729)	(4,832)	
Shareholders' funds:						
Share capital	1,040	1,040	1,040	1,040	1,040	
Revaluation reserves	(1,541)	(4,008)	(4,534)	0	0	
Retained earnings/(losses)	3,735	3,074	483	(4,769)	(5,872)	
Minority interests	0	0	64	0	0	
Shareholders' funds	3,234	106	(2,947)	(3,729)	(4,832)	

Source: IMS/MMC analysis.

The table shows negative net assets for the last three years and net current liabilities including net cash. The company was also loss-making during the same period (see Table 3.14) which indicates that it would have been heavily reliant on group financial support in order to continue.

Source

History and business

3.80. Source was developed as part of Walsh and demerged in April 1996 by way of capital distribution. At that time, Source had developed a range of data services for pharmaceutical companies primarily based on a proprietary database (named *Alpha*) of prescriptions dispensed in the USA as well as other databases. Since 1994 Source had been working to develop similar databases in several European countries, the operations in which were transferred to Source Europe prior to their acquisition by PMSI.

3.81. As referred to in paragraph 3.53, Source Europe embraced operations in the UK, France, Germany, Italy, Belgium and the Netherlands in each of which its intention was to build prescription database services.

3.82. Mr Handel Evans (former Chairman of Walsh as well as the former Chairman of Source and PMSI) told us that obtaining the various regulatory approvals took much longer in most European countries than expected, which had driven up development costs very substantially. These delays had been exacerbated in July 1997 by a letter (reproduced at Appendix 4.2) sent by the DH to Health Authorities in England advising that GPs and pharmacists who disclosed prescribing or dispensing information to data companies would be incurring legal risks and strongly discouraging all such disclosures on policy grounds.

3.83. At the time of Source's demerger from Walsh, its identifiable net liabilities were US\$4.1 million (£2.6 million) before the contribution of US\$5.2 million (£3.3 million) in cash by

Walsh to consummate the demerger. Various other assets and liabilities were also added including Walsh's holding in PMSI (then amounting to 9.2 per cent) and the licence agreements referred to in paragraph 3.50. As referred to in paragraph 3.52, Source was sold in December 1997 partly to NDC and partly to PMSI.

Financial performance

Group

3.84. Table 3.16 summarizes the trading performance of Source. We were unable to obtain any consolidated figures for the year ended 30 June 1997.

TABLE 3.16 Source: trading performance

	£'000		
	Years ended 30 June		Period ended 16 April 1996
	1994	1995	
Sales	31,620	31,227	25,776
Loss before tax	(4,840)	(1,701)	(1,007)
Tax	(148)	0	0
Loss from operations	(4,988)	(1,701)	(1,007)
Gain/(loss) on disposals	1,144	705	(119)
Net loss	(3,845)	(996)	(1,126)

Source: Walsh Form 10-K.

3.85. Source's trading performance is significant for its record of consistent losses partially offset by gains on disposals. The losses were, however, caused by Source Europe, the trading results of which are set out in Table 3.17.

TABLE 3.17 Source Europe: financial performance

	£'000					
	Years ended 30 June				Three months ended 30 September	
	1994	1995	1996	1997	1996	1997
Sales	-	-	-	252	-	481
Production costs	(319)	(1,260)	(3,282)	(4,534)	(1,110)	(1,807)
Selling, general and administration costs	(456)	(1,820)	(4,699)	(6,170)	(1,420)	(1,340)
R&D costs	(51)	(258)	(1,369)	(2,035)	(352)	(148)
Amortization of intangible assets	-	-	(5)	(21)	(1)	(9)
Operating loss	(827)	(3,339)	(9,354)	(12,508)	(2,883)	(2,822)
Interest income	-	-	1	36	-	6
Interest expense	-	-	-	(42)	(44)	(1)
Net loss	(827)	(3,339)	(9,353)	(12,514)	(2,927)	(2,817)
Shareholders' funds	-	-	(3,970)	(11,268)	(6,861)	(14,908)

Source: PMSI/ MMC translation.

3.86. The table shows that sales began only in 1997 whereas production and other costs were significant and had been increasing since 1994 as a prelude to establishing the European businesses. The aggregate loss over the periods shown, up to 30 September 1997, was US\$46 million (£29 million). A comparison with the operating results for Source in Table 3.16 shows that, without Europe, Source was profitable in 1995 and 1996.

3.87. The former Chairman of both Source and PMSI at the time, Mr Handel Evans, told us that losses in the 'current' 1998 financial year would amount to approximately another US\$17 million (£10.3 million). Delays in obtaining approvals in Europe have already been referred to in paragraph 3.82.

3.88. As referred to in paragraph 3.52, NDC acquired Source (excluding Source Europe) together with PMSI's OTC business and PMSI's approximately 26 per cent share in a joint venture with Source, in December 1997. The price paid for all three assets was US\$131.1 million (£79 million) and the net tangible assets acquired were a deficit of US\$7.2 million (£4.3 million). The ensuing goodwill of US\$138.3 million (£83 million) was written off as to US\$67 million (£40 million) by way of in-progress R&D costs and the remaining US\$71.3 million (£43 million) was capitalized as goodwill to be amortized over periods of up to 20 years.

UK

3.89. Source UK commenced trading in April 1996 as a vehicle for the Source business demerged from Walsh UK (as part of the demerger of Source by Walsh referred to in paragraphs 3.40 and 3.80). Its financial performance is summarized in Table 3.18.

TABLE 3.18 **Source UK: profit and loss account summary**

£'000			
Years ended 30 June			
	1996*	1997	1998
Sales	0	1,066	1,830
Operating (loss)	(864)	(2,498)	(3,823)
Net interest received/(paid)	1	(117)	(495)
Loss before tax	(863)	(2,615)	(4,318)
Tax	0	0	0
Loss after tax	(863)	(2,615)	(4,318)

Source: Source and IMS.

*Business commenced on 17 April 1996.
 Note: Results for 1996 were for the period 17 April to 30 June only.

3.90. The Source UK business was evidently embryonic, as can be seen in Table 3.18: in the 2½ months to 30 June 1996, sales were nil and operating costs £864,000. In the following year, sales were £1.1 million and operating costs had reduced by approximately 14 per cent on a time-apportioned basis to leave a loss before tax of £2.6 million. In 1998 sales increased by £0.8 million to £1.8 million but costs rose by £1.3 million resulting in increased losses. The balance sheet in both years consisted of £1 million paid-up share capital and negative working capital reflecting the accumulated losses.

3.91. Table 3.18 shows 1997 sales of £1.066 million. However, a comparison with Table 3.17 shows Source Europe achieving sales of only £0.252 million in that year. We have been unable to obtain an explanation for this disparity: the respective figures were produced by different management teams at different times.

NDC

3.92. NDC is a US corporation which is primarily a provider of information processing services and systems to the healthcare and electronic commerce markets. It also provides business management services to hospitals and physicians. Examples are medical insurance claims processing, formulary management, prescription editing and analysis and pharmacy practice management systems.

3.93. Electronic commerce includes credit and debit card transaction processing, portfolio risk management, corporate purchasing card services and multinational cash management and transfer services.

3.94. NDC had sales of US\$649 million (£393 million) in the year ended 31 May 1998 and generated an operating loss of US\$26 million (£15.8 million) after non-recurring charges of US\$120 million (£73 million). These chiefly related to the acquisition of PMSI's OTC business, its US joint venture with Source and Source itself (referred to in paragraph 3.52). The total price paid for these businesses, which had net liabilities of US\$7.2 million (£4.3 million), was US\$131 million (£79 million) thereby generating goodwill of US\$138 million (£84 million) of which US\$67 million (£41 million) was expensed as in-process R&D costs. Their trading performance is summarized in Table 3.19.

TABLE 3.19 PMSI and Source: trading performance summary

	£'000			
	Years ended 30 June			
	1995	1996	1997	1998
Sales	42,773	45,940	52,500	65,306
Operating expenses	<u>38,027</u>	<u>41,231</u>	<u>44,709</u>	<u>53,575</u>
Operating income	4,746	4,709	7,791	11,731
Net interest expense	(476)	(166)	(51)	(447)
Other income/(expense)	<u>(92)</u>	<u>(214)</u>	<u>(108)</u>	<u>427</u>
Profit before tax	4,177	4,328	7,632	11,712
Tax	<u>1,001</u>	<u>765</u>	<u>1,443</u>	<u>-</u>
Profit after tax	3,176	3,564	6,189	11,712

Source: NDC/MMC translation.

3.95. The table shows both sales and profit after tax increasing over the four-year period ended in June 1998. The profit margin on sales also widens over the period from 11.4 to 17.9 per cent.

3.96. In July 1997 NDC acquired two UK companies, Chemtec Systems Limited and Hadley Hutt Computing Limited, both of which provide pharmacy management software. These acquisitions were NDC's first in the UK and have been integrated into existing NDC operations offering complementary products and services. In January 1999 NDC also acquired John Richardson Computers Limited (JRC), another pharmacy management software company, which gave NDC a significant share of the UK market for such systems.

The merger and subsequent events

3.97. On 23 March 1998 PMSI and Cognizant (then IMS's parent company and since renamed Nielsen Media) jointly announced that they had signed a definitive agreement for Cognizant to acquire the entire stock of PMSI and to merge PMSI with Cognizant's IMS Health business subject to PMSI stockholder approval and regulatory clearance.

3.98. On 9 June 1998 PMSI announced that because of the continuing review by the Securities and Exchange Commission and various anti-trust authorities of the proposed acquisition of PMSI by IMS, that transaction would be incapable of completion prior to Cognizant's planned reorganization (see paragraph 3.10). Accordingly, accepting PMSI stockholders would receive IMS shares as consideration instead of Cognizant shares.

3.99. On 22 July PMSI and IMS jointly announced the signing of an agreement in principle for IMS to acquire the non-US assets of PMSI (except for its businesses in Belgium). This restructuring of the previously announced agreement was stated to be in view of the delay and uncertainty created by the ongoing antitrust reviews.

3.100. On 5 August PMSI announced that given the major issues it faced in completing the sale of the entire company to Cognizant and the uncertain timetable for their resolution, it had completed the sale to IMS of all its businesses outside the USA except for those in Belgium. The consideration was US\$75 million (£45 million) payable in IMS common stock. The execution date for the sale and purchase agreement for these transactions was 3 August 1998.

3.101. Under the sale and purchase agreement IMS had a call option for three months on PMSI's four Belgian subsidiaries¹ at no extra consideration. The Belgian subsidiaries comprised all the subsidiaries of PMSI that conducted any business or operated in, derived any revenues or income from, or owned any assets in, Belgium. They had not been acquired because of concerns raised by the Belgian competition authorities that the merger would lead to the reinforcement of IMS's dominant position in the Belgian market for sales monitoring services for products sold to pharmacies.

3.102. The Belgian Competition Council (BCC) found that PMSI's Belgian operation was debt laden and likely to close down with the result that IMS would acquire PMSI's market share. The BCC therefore concluded that despite IMS not having exercised its option to buy the Belgian subsidiaries, there was a concentration affecting the Belgian market and that accordingly it had jurisdiction to review the transaction. On 25 September 1998 it referred the matter back to the Competition Service for further investigation and for a report by 26 October. On 2 November IMS exercised its option over PMSI Belgium SA which operated PMSI's profiling business but the closing of such purchase was conditional on approval from the BCC. On 14 December the BCC concluded that IMS should dispose of PMSI Belgium SA within three months, the buyer to be an actual or potential competitor, credible, viable and independent of the IMS group. Accordingly, for the sole purpose of complying with this order IMS waived the condition and acquired PMSI Belgium on 4 January 1999. An independent ad hoc trustee will be appointed to handle the sale. IMS informed us that it has filed an appeal against this decision.

3.103. IMS told us that its UK business had begun some integration with that of PMSI including transferring staff to the IMS payroll, developing new, common products and sharing of databases although the latter were being separately maintained for the time being. So far as Source UK was concerned, IMS told us that seven of its original 23 staff had resigned since the acquisition and that Source UK had no sales or customer support staff left. A similar number had left from PMSI UK. IMS has given undertakings to the Office of Fair Trading, *inter alia*, to maintain IMS and PMSI (including Source) as separate businesses pending the outcome of our inquiry.

¹The subsidiaries were PMSI Belgium SA; Source Informatics Belgium SA; Inedi SA; and Medical Time Communication.