RENTOKIL/CANNON COMPLETED MERGER INQUIRY

Summary of hearing held with PHS on 22 August 2018

Customer segmentation

1. PHS told us that it sells to customers through a number of channels including field sales, telesales and via the internet. Sales are made directly to end customers, via facilities management companies, and through framework agreements, although end customers can influence the choice of provider even where supplies are made through a facilities management company.

2. More sizeable customers typically require services to be delivered on consistent basis nationally. This requires a national infrastructure in terms of a service centre network, vehicle fleet, staff, equipment installation, IT systems, management information and sales and account management capability. National customers account for a significant proportion of revenue and locations serviced, but are relatively small in terms of customer numbers and represent a very small percentage of the total number of customers in the customer base.

3. PHS also said that end customers in different sectors such as retail and healthcare may have slightly different dynamics. Public sector customers can either procure directly or can have specialist procurement organisations that put in place framework agreements through which they purchase.

Price setting

4. PHS told us that, in setting prices, the revenue achieved per visit is a key factor and that the revenue that is likely to be achieved needs to be considered alongside the cost of serving the customer. The main variable cost of serving a customer is the cost of making visits to the customer's site. This cost may depend on customer density in local areas and the number of products which a customer takes in each location.

Product segmentation

5. PHS said that its customers do not tend to purchase all of its 12 service lines. Some customers may use other suppliers for certain service lines and many customers will not purchase certain service lines at all – although the majority of washrooms will have sanitary disposal, air freshener, soap and a hand

drying facility. The service lines purchased may depend on the nature of the customer. The vast majority of national account customers take waste disposal and may not purchase the same service lines in each location, although typically they will usually take sanitary and nappy waste disposal services.

Competitive dynamics

6. PHS said that the market has grown over the last six years and that it generally follows GDP. Competitive pressure has, in its view, grown somewhat over the last five years or so, partly due to facilities management customers building greater buyer power by consolidating their position. Smaller companies purchasing on a regional or local basis tend to have less buyer power.

7. PHS said that sanitary disposal and nappy disposal is carried out by washroom services providers, but that other products may be supplied by a wider range of suppliers, eg air freshening can be self-supplied and soap may be provided by cleaning companies. PHS therefore has a lower share of the market for service lines other than sanitary and nappy disposal. However, in PHS's view, it is easy for a customer to purchase these other service lines from PHS and it is able to supply additional service lines to customers efficiently as the incremental cost is low.

8. In relation to sanitary disposal, PHS said that, in its view, only Rentokil Initial and Cannon Hygiene tended to compete with it for national accounts. PHS said that other competitors were rarely seen.

9. PHS said that the way it supplies sanitary waste disposal is to remove the bins, to clean them off-site and then return them to the washroom. The alternative model of liner exchange has been around for a long time and PHS had not seen any change in customer demand for this type of service. PHS considers bin exchange to be more hygienic, safer and a better customer experience. It also commented that it was Cannon's policy to deliver this service in this way.

10. In order to serve national customers, PHS said that it is essential to understand how their central procurement teams work and to be able to handle complex contractual negotiations which are then applied nationally. It is also critical to be able to offer a high and consistent standard of operational national service delivery on an ad-hoc or scheduled basis and provide a customer service, account management and IT capability nationally which might include the provision of bespoke levels of customer reporting, data and invoicing. The customer journey for single site or localised customers is

different and smaller competitors are able to compete more effectively at this level.

Barriers to entry

11. PHS said that supplying waste disposal was more complicated than other service lines, particularly when servicing national customers. As a consequence, barriers to entry are higher in waste disposal than in other service lines.

12. In order to supply waste disposal at scale, PHS told us that it is often necessary to bulk up waste at a depot before it is disposed of, but doing so requires a licensed waste transfer station. In urban areas, it could be more difficult to obtain a licence, especially in comparison with more rural areas. For bin exchange, it is also necessary to have a depot with bin washing facilities. Finding an appropriate site, obtaining a licence and putting in place the necessary infrastructure may take 18 months or more. It would take much longer and require very significant investment to build a national infrastructure.

13. To supply effectively across the UK, PHS said that, in its view, it is necessary to have around 20 service locations, a large vehicle fleet and a national pool of staff in order to reach most of the UK population efficiently. PHS said that is important to deliver services nationally to customers in a consistent manner either in a scheduled or ad-hoc basis (to meet surges in customer demand). PHS also said that it is important to have account management teams, customer service processes, IT platforms, 24/7 coverage and the ability to recruit staff. PHS does not consider it feasible for a new entrant to supply only national customers.

14. PHS is not aware of facilities management companies supplying sanitary waste and nappy disposal. PHS said that facilities management companies sub-contract to washroom specialists, largely to Rentokil Initial or themselves.

15. In PHS's view, site-based facilities management companies which supply a range of services at a customer's site are distinct from route-based facilities management companies which operate depots with a fleet of vans servicing customers at many different locations. PHS does not consider that site-based facilities management companies have the capability or desire to provide washroom services, particularly waste disposal services, as they cannot do this economically or effectively.

16. PHS is not aware of any waste disposal companies not currently serving washrooms that would enter the supply of washroom services. Berendsen is

not currently considered a significant player in the UK washroom services market.

17. In relation to barriers to expansion, PHS said that it would be risky for a regional supplier to invest in the necessary infrastructure to provide services nationally as it may not subsequently win any national contracts, particularly given that many national customers have existing three to five year contracts with Rentokil Initial, Cannon or PHS. Customers may also be concerned about the risk of a fall in service quality if they switch to a supplier with little or no experience in dealing with large national customers. In PHS's experience, large national customers require proof from a supplier in the form of another customer reference account in a similar sector before considering that a supplier is competent to handle their needs. Relationships with customers are also important. Aside from these factors, PHS does not consider barriers to switching supplier to be huge.

18. PHS said that Cathedral and Mayflower have not broken through into the same realms as Rentokil Initial, Cannon and PHS in terms of national supply, despite being in the market for many years.

Views on the merger

19. PHS said that at the national level, one fewer competitor would result in two players providing washroom services and this could affect prices. At a local level, however, PHS said that local players have been gaining market share.