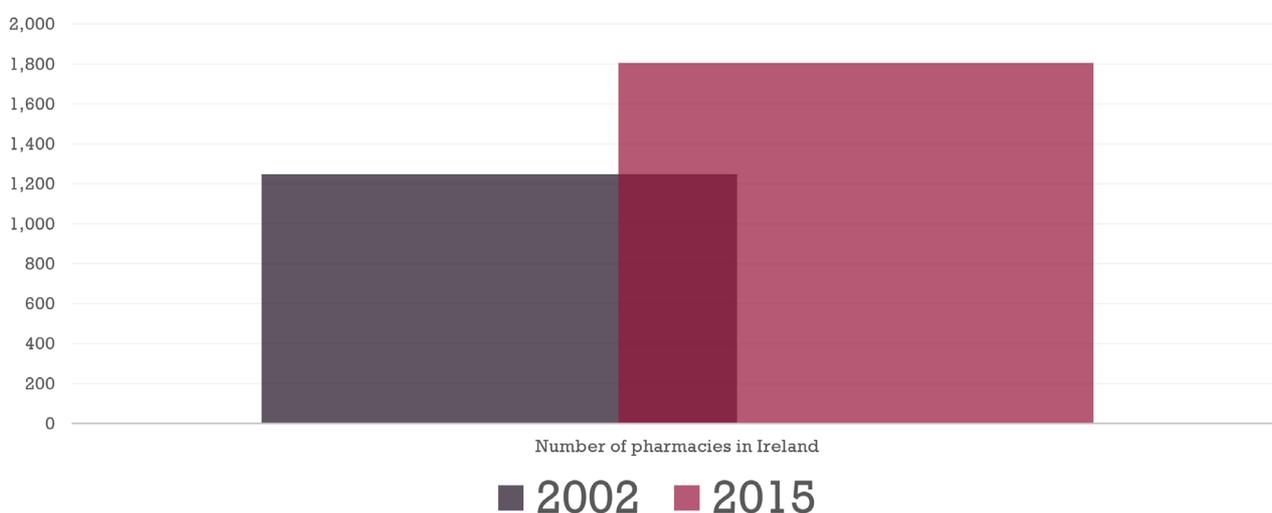


Pharmacy Acquisitions – What you need to know

At the end of February, Fitzgerald Power Chartered Accountants, in conjunction with commercial law firm and tax experts Davy and William Fry, hosted the Pharmacy Acquisition seminar in Citywest Hotel, Dublin to provide pharmacists and pharmacy groups with information on how to expand their business and to show how the Irish pharmacy market is currently developing.

Number of pharmacies in Ireland



PHARMACY
ACQUISITIONS
SEMINAR

The turnout on the day was larger than anticipated which showed that there is a definite move towards expansion and further development within the Pharmacy sector over the next few years.

Stuart Fitzgerald, Director at Fitzgerald Power delivered a presentation and spoke about how the healthcare and technology sectors were the two top sectors internationally in 2015 for business combinations.

“The appetite we saw amongst healthcare executives in 2015 was shared by their counterparts in the retail sector,” explained Fitzgerald.

“Ernst & Young produce a very interesting quarterly barometer of mergers and acquisitions and in Quarter 4 2015, what they found was that 59% of retail executives expected to pursue acquisitions in the next 12 months.

“Of those, 72% were seeking bolt on acquisitions that would complement existing business models so they weren’t straying too far outside their comfort zones. A further 55% had three or more deals already in their pipeline proving that there is a huge appetite amongst retail executives and healthcare executives for acquisitions.”

Fitzgerald gave an insight into what he believes is driving the market currently and said factors including boardroom confidence, cheap debt, pressure to become more efficient in a slow growth economic cycle, and a desire to keep pace with consolidating rivals were among the reasons for growth in mergers and acquisitions.

IRELAND – THE FRAGMENTED MARKET

Each year, more pharmacies are

opening in Ireland but according to Stuart Fitzgerald the Irish market is developing in a different capacity than other markets abroad.

“We’re a little bit at odds with our peers in the US and the UK when it comes to ownership profile. 63% of pharmacies in the US are owned in groups of six shops or more and in the UK that figure is on par at 61%. Whereas in Ireland only 26% of pharmacies are owned in groups of six shops or more. You have to wonder why that is.”

Fitzgerald suggested that this was driven in part by deregulation and the amount of new pharmacy openings year on year.

“Prior to deregulation, the market in Ireland was very restricted from an ownership point of view but after deregulation, the number of pharmacies in Ireland exploded. Between 2002 and

2015, the number of pharmacies in Ireland grew from 1,249 to 1,805 pharmacies respectively.

“There were 28 new pharmacy openings in Ireland in 2015. We’re continuing to open more independent pharmacies in Ireland, particularly against what you see around the rest of the world. In the UK for example, there is essentially a finite number of pharmacies in existence therefore as operators expand their footprint in the market, it consolidates quite quickly.”

Fitzgerald pointed to 2009 as a turning point in Irish Pharmacy and said “that was the point we might logically have expected the pharmacy market in Ireland to begin consolidating at a rapid rate but the recession, the FEMPI Act, a lack of available funding from banks, a lack of available funding internally on company balance



sheets, the personal circumstances of vendors and purchasers, all meant that the pharmacy market in Ireland was artificially quiet in the FEMPI years.

“Now, we’re starting to see that loosening up. If we look at PSI statistics for 2014 we saw 45 changes of ownership and in 2015 that figure rose to 92. While a pharmacy sale is not the only event that will trigger a PSI change of ownership, these statistics do point to an increase in transactional activity.”

VALUING YOUR PHARMACY

As activity picks up and with an increase of interested parties on the buying side, Fitzgerald gave advice on how pharmacists can value their pharmacy. He gave a working example of a pharmacy using figures that he collated from current market trends.

“If turnover is falling by 4.3% in this pharmacy, I expect that,” he said.

“I expect that because of FEMPI and because of reference pricing. To really understand how to value this pharmacy, however, I need to look at what is driving that turnover performance.

“The turnover performance is affected by things such as State scheme items which are down by 3.3% in this pharmacy. This is due in part because there was 4% less medical cards in issue in the country in 2014 and also because the DPS threshold of €144 pushes some patients out of the DPS scheme. The prescription levy of €2.50 is also a barrier for GMS patients to fill scripts.”

Fitzgerald continued, “On the other side of the dispensary, private medicine consumption is up because patients are falling down through the medical schemes and into the private category. So what I’m looking to do here is, I’m

looking to analyse item numbers, analyse them scheme by scheme and understand the trends, good and bad and what is driving those trends. It’s not just about the numbers, it’s about the factors that are driving those numbers.

“For example, is there a local competition factor that I need to be aware of that means the item number performance is not at the level I would expect for the market? What’s the position of local GPs? Is the pharmacy very reliant on one GP surgery, and if so, what’s the relationship like with that GP surgery?”

“All of these things need to be looked at,” he explained.

The next area that should be addressed when looking at the value of a pharmacy is revenue per item according to Fitzgerald.

“Revenue per item is interesting for a number of reasons but in particular it is interesting if there is a trend outside of what I expect. That is an indication that the pharmacy is earning additional fees outside of the standard fee structure. If that is the case, the question of whether or not that is sustainable arises. If it is not sustainable, I need to price that into my valuation.”

Another factor to take into consideration when valuing the pharmacy is fee structures, i.e. the pricing structures that are under the control of the pharmacist – private fees, OTC & retail mark-up etc.

“That is something that may need to be priced into the ultimate valuation of the pharmacy,” explained Fitzgerald.

Once the turnover has been addressed, the next thing to look at in terms of valuing the pharmacy is profit drivers, in particular gross profit.

“In this example, when we look at

monetary value, the gross profit is falling in this pharmacy but again we expect to see that,” said Fitzgerald.

“What I should be asking myself here though is what is the future impact of reference pricing and how much will that affect gross profit in the years ahead? What is the generic penetration rate like? Will the pharmacy be able to claw back some of the lost margin through better procurement? What is the gross profit per item like? Is it sustainable? It is important to ensure that you are happy with the gross profit base when valuing the pharmacy.”

Fitzgerald explained that other key areas to evaluate when determining the value of a pharmacy are wages and salaries, rent and overheads.

“In terms of wages and salaries, we’re starting to see these costs increase in Pharmacy again but there are macroeconomic rather than Pharmacy specific reasons for that. Rates of pay and whether or not they are in line with market trends is an important factor to check.

“In terms of rent, it is always important to check whether it is in line with sector expectations, how long the lease is and what the review structure of the lease is. Also the relationship with the landlord is very important and whether the landlord will consent to a takeover of the pharmacy by another operator.”

Fitzgerald explained that when it comes to overheads, it is important to ask whether you can run the pharmacy more efficiently than it is already being run. If not, then the maintainable earnings for the pharmacy need to be checked as that is what it is really about.

“The maintainable earnings are more important than the published earnings from the previous year. A buyer will not focus on the earnings that are displayed on the profit and loss account for the previous year; the buyer wants the right to a future income. So the buyer will want to know the projection into the future, how sustainable the earnings base going forward is and that’s what I need to base my valuation on.”

THE FUTURE OF PHARMACY ACQUISITIONS

Fitzgerald is reluctant to fully predict what way the Pharmacy market will go in terms of valuations over the next few years but he does believe the market will remain competitive.

“What we can say, is that the market is well priced from a vendors perspective. Just how sustainable valuations remain will depend on the long term profit projections for the sector and where reference pricing brings us.”

In terms of a growth in pharmacy valuation multiples, Fitzgerald said that competition in the bidding process will play an important part in what may happen over the next few years.

“The more competitive the bidding process, the more likely it is that we’ll see increased valuation multiples. The appetite of the banks is important too and based on current banking conditions, there’s only so far multiples can go. If a prospective purchaser is relying on a bank to finance 75% of a deal, there’s only so high the valuation can go.”

Lastly, Fitzgerald said that the availability of alternative liquidity is an important factor.

“The amount of alternative liquidity available from internal sources on company balance sheets and externally out there in the market is going to play an important role. That is really very difficult to predict, but what we can say is that the market remains interesting from a purchaser’s perspective.

“The sector remains interesting because purchasers are looking to build scale as market conditions change. On the other side of the deal equation, valuations remain very well priced. Deals and prices are as good as we’ve seen them since before the recession. Therefore, we remain very positive about the outlook for the pharmacy mergers and acquisitions market from a transactional point of view over the next three to five years.”

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