



TAYLOR WOODINGS

## NEWS FLASH

January 2010

### Supermarkets Shut out of Pharmacy for Next Five Years

Pharmacies already operate in a tight fiscal environment. Now, there is the very real threat that the industry faces further cost pressures with the announcement of a \$1b cut in government spending over the next five years. But against this, in a major win for the pharmacy industry, supermarkets will continue to be prohibited from operating pharmacies on their premises for at least five years. Taylor Woodings partner Matt Adams reviews the current state of the pharmacy industry in light of recent developments.

#### A Tough Two years...

Like many industries that are tied to the retail sector, the pharmacy industry has been doing it tough over the last two years. Profit margins have fallen due to a higher dependence on dispensary of Pharmaceutical Benefits Scheme ("PBS") supported drugs within pharmacies. Additionally, the tightening retail industry has bitten into the historically profitable over the counter sales. Added to this, the value of pharmacies are only now beginning to recover after a period of lower values. Lower profits, a squeeze on available funding and uncertainty over pharmacy regulation, have all impacted negatively.

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#### "...difficult circumstances"

Against this backdrop, the federal government and the Pharmacy Guild of Australia, Australia's peak pharmacy body, have been negotiating the fifth community pharmacy agreement ("Community Pharmacy Agreement") due to take effect on 1 July 2010. The Community Pharmacy Agreement is the underlying agreement that governs the operation and funding of Australia's community pharmacy model. It covers items such as location rules, government subsidies in regard to certain drugs through the PBS and government funding for certain efficiency and health programs.

On 24 December 2009 the Honourable Nicola Roxon, Minister for Health, announced that the federal government had reached an agreement with the Pharmacy Guild of Australia creating the fifth community pharmacy agreement. Broadly the agreement includes:

- \$15.1b in federal funding over the next five years
- Current location rules remain (1.5km between pharmacies with exception for large medical centre's and other exceptions)
- Continued prohibition on supermarkets from operating pharmacies within stores or having public access from within stores. A supermarket is defined as a retail store or market, the primary business of which is the sale of a range of food, beverages, groceries and other domestic goods
- A two year freeze on dispensing fees (the fee paid to pharmacists for their professional advice and dispensing a drug)



- Removal of the 40 cent incentive payment if online systems are used

Pharmacy Guild president, Kos Sclavos, is quoted in the press as saying that negotiations were “extremely tough and that the Guild and government has reached agreement that community pharmacy can accept in difficult circumstances.”

### The Agreement: A Real Mixed Bag For The Pharmacy Industry

In a massive boost to the industry, supermarkets have largely been kept out of the pharmacy industry for at least a further five years through a continued prohibition from operating pharmacies (that is a retail outlet that supplies pharmaceutical benefits) on supermarket premises. This, in conjunction with the fact location and ownership rules remain, should have a positive effect on pharmacy values. With the threat of supermarkets entering the industry diminished, the main driver lowering values has accordingly eased.

However, the cut in government funding will no doubt lead to the downsizing or even scrapping of many programs important to the pharmacy industry.

### Broader Government Health Reform

Apart from the Community Pharmacy Agreement, the federal government’s health reform agenda includes a wider role for community pharmacies in terms of the service and consultation they provide consumers. Pharmacies will now need to decide how they structure their fee and operational models to take this into account e.g. possibly charging a consultation fee for certain services.

There is no doubt the pharmacy industry is entering some challenging times. To be successful a pharmacy will need very tight control of its costs, have a competitive fee model that adequately services its costs and owner’s contribution and have a defined pharmacy model. In regard to this last point, there are essentially three main pharmacy models that operate in Australia:

- **Full service dispensaries** where the customer receives a consultation from the pharmacist who provides prescription medicines and provides value added health advice and services;
- **Discount dispensaries** where the customer orders or buys the prescription medicines based on price and receives little or no consultation. These business may be shop front or online retailers and usually offer price matching guarantees and loyalty discount programs;
- **Pharmacy retailers** selling “over the counter” pharmaceuticals, which do not require prescriptions and general health care products. These may also be online retailers.

Each of these models can be profitable and successful provided their cost and operational structures reflect that model. However, problems are often encountered when a pharmacy attempts to straddle two or more models. This results in a diminished ability to compete with surrounding pharmacies who stick to one model as the pharmacy loses their competitive advantage in either having a lower cost structure (in the case of discount dispensaries) or higher gross profit margin (in the case of full service dispensaries). With the federal government pushing for more involvement by the pharmacy industry in Australia’s healthcare, choosing the right model and implementing the right cost and operational structures are more important than ever.

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## How Taylor Woodings Can Assist

Taylor Woodings has specialist expertise in the pharmacy sector, having recently completed several assignments that involved many aspects of advisory work including providing valuation services, corporate advisory services and formal insolvency services including the trading on and sale of pharmacies. We have developed strong working relationships with the major wholesalers, Medicare, the Pharmacy Guild of Australia and specialist third party service providers in areas such as retail management, valuations and sales and legal services.

Taylor Woodings has conducted numerous assignments within the pharmacy industry over recent years including:

- Acting on behalf of secured lenders including financiers and major wholesalers as Receivers & Managers of several pharmacies – both single and multi – site groups. This included the trading and sale of the businesses;
- Acting for financiers and wholesalers as investigating accountants in relation to numerous pharmacies experiencing trading difficulties. Our advice included identifying the formal and informal strategies that could be employed to exit the exposures;
- Conducted a pre-lending review of a major buying group with 25 members within the pharmacy industry that was rapidly expanding its business nationally via a new business model;
- Advising major wholesalers in relation to difficult trading accounts;
- Assisting pharmacy owners experiencing difficulties with their operational strategies including developing and implementing turnaround or exit strategies focused on maximising outcomes for all parties; and
- Several valuations of single and multi-site pharmacies. Taylor Woodings is a panel pharmacy valuer to several leading banks.

If you wish to have a confidential discussion about any matter raised in this newsletter, please contact Matt Adams or Quentin Olde or one of the other Taylor Woodings partners in Sydney, Melbourne or Perth.

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