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INDUSTRY UPDATE

Drug Bust!

The Pharmacy Industry

Can full service pharmacies survive in a market trending towards discount operations?

Historically the pharmacy industry has been a strong performer within the wider retail industry. The industry has enjoyed protection and the benefits of a government funded medical rebate system in the form of the Pharmaceutical Benefits Scheme (“PBS”). However, this position is changing with the industry feeling a squeeze at both ends of the profit spectrum.

On the revenue front there has been a decrease in turnover due to the softening retail cycle effecting “front of shop sales” and the emergence of several new entrants into the market with a “supermarket pharmacy” style such as Priceline and Chemmart. In addition margins are being eroded by the continued pressure from the commonwealth government to slash the rebates paid to pharmacies from dispensed prescriptions under the PBS.

At the other end relative costs are increasing driven by a difficulty in maintaining historical industry benchmarks in areas such as wage costs, rents and insurance.

Added to these issues is the continued push from both Coles Myer and Woolworths to enter the market. Although it appears that they have been thwarted in their attempts to enter the retail pharmacy segment at this stage both have expressed interest in entering the wholesale market segment, either through a joint venture with one of the three existing wholesalers or alternatively by establishing their own wholesaling arm. Such a move could see margins squeezed even further.

Coles Myer has signalled its intent with a controversial \$50 million acquisition of online pharmaceutical retailer Pharmacy Direct in March this year. The acquisition came just days after the federal government proposed changes to pharmacy regulations which extended the ban on supermarkets setting up pharmacy businesses until at least 2010. Coles Myer have openly said that the acquisition will enable the group to gain an understanding of the industry within the existing guidelines in preparation of legislative changes enabling them to expand to include pharmacies in their supermarkets.

The Coles Myer acquisition has alarmed industry bodies and policy makers including the Pharmacy Guild of Australia who have concerns that online retailing of pharmaceuticals reduces the interaction between pharmacist and patients to non-existent or dangerous levels.

There are essentially three types of pharmacy businesses in Australia.

- **Full service dispensaries** where the customer receives a consultation from the pharmacists who provides prescription medicines and provides value added health advice;
- **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 retailers or online retailers;
- **Pharmacy retailers** selling “over the counter” pharmaceuticals, which do not require prescriptions and general health care products. These may also be online retailers.

In many cases two or more of these business models co-exist in one operation. Most full service pharmacies include large retail floor space. Primarily each pharmacy operation is both a professional service provider and a retail operation. It is the quality and level of the service being provided which concerns industry regulators and professional bodies. Even though the total price may only be 15% higher when sold by a full service dispensary, the final price charged to the customer may be as much as 300% higher as a result of the PBS rebate. For example a drug may sell for \$12 online or \$36 over the counter whilst in both cases the government contribution under the PBS would be \$120. Naturally this differential is attractive to consumers.

The question is can full service pharmacies compete and survive in a market trending towards discount operators. There are many factors impacting on this but it appears that both models have a future however smaller family run and sole trader pharmacies may only be able to survive if they decide to compete on service quality and not on price. There is an urgent need for these operators to position themselves in the market in readiness for the deregulated market. There are a number of ways this can be achieved but most importantly brand requisition is becoming more important. Small traders need to consider the benefits of buying groups



and franchising networks which attempt to differentiate themselves based on service quality and brand.

Taylor Woodings Experience

Taylor Woodings has specialist expertise in the pharmacy industry having recently been involved in several assignments that have involved both the trading on and sale of pharmacies. We have developed strong working relationships with the major wholesalers, the Health Insurance Commission, The Pharmacy Guild and specialist third party service providers in areas such as retail management, valuations and sales and legal services.

Our experience has highlighted that should problems exist it is an opportune time to act for both owners and financiers as despite the issues mentioned above the demand for pharmacy acquisitions is high and supply is limited due to the regulatory and licence restrictions. This pressure is driving up valuations to healthy levels. It is not anticipated these levels will be sustainable if deregulation occurs.

Taylor Woodings has a large database of parties interested in acquiring pharmacies.

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

- Acting as Receivers & Managers of several pharmacies – both single and multi – site groups. These assignments included the trading and sale of the businesses;
- Acting for financiers as investigating accountants in relation to several 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 franchisor with 25 franchisee members within the pharmacy industry that is rapidly expanding its business nationally via a new business model;
- Advising major wholesalers in relation to difficult trading accounts; and
- Assisting pharmacy owners experiencing difficulties with their trading and developing and implementing turnaround or exit strategies focused on maximising outcomes for all parties.

Through our various assignments we have developed a detailed understanding of the legislative and practical issues associated with formal insolvency appointments and commercial issues associated with the industry.

Should you wish to discuss this matter or require more detailed advice on a particular situation please contact:

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