

The pharmacy acquisitions market

Stuart Fitzgerald, Fitzgerald Power

The market for pharmacy transactions has been buoyant in the seven months since the Pharmacy Acquisitions Seminar which we ran in conjunction with Davy and William Fry last February.



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During this period the first three tranches of Allcare pharmacies have come to the market generating considerable interest, while general activity continues apace with a large number of opportunities coming to the market.

Valuation methodologies and multiples

Pharmacy valuations have been strong in 2016 with investor and bank sentiment robust following a long period of uncertainty which followed the recession and the FEMPI Act.

There has been little change if any in valuation methodologies with the earnings basis still the most common method employed by purchasers and vendors when valuing pharmacies. The earnings basis takes maintainable EBITDA (earnings before interest, tax, depreciation and amortisation) and applies a price earnings multiple to arrive at a goodwill valuation.

This goodwill value is increased by working capital at completion date to arrive at a final enterprise valuation. In recent years the calculation of maintainable earnings has been open to interpretation due to the uncertainty caused by

reference pricing and other environmental factors but now that these impacts are largely understood the calculation of maintainable earnings has become less contentious.

Earnings multiples of between 4.5 and 6.5 times EBITDA are generally being achieved in the market with a variety of factors impacting the ultimate price purchasers are willing to pay. These factors include; the profile of the target pharmacy, the revenue and profit growth opportunity, local competition, local GP profile, environmental factors, the culture of the target pharmacy and recent deals in the sector.

Risk

The earnings multiple reflects the purchaser's appetite for risk and while the impact of FEMPI and reference pricing are now broadly understood there remain three principal risk factors that have yet to be fully understood. These factors are:

1. Phased dispensing
2. Owings policies
3. The impact of further government intervention

Accurately assessing the full impact of these factors on maintainable earnings is not straightforward. As a result valuers and purchasers are adjusting multiples accordingly to account for the uncertainty that currently exists. This is occurring on a case by case basis with some target pharmacies more susceptible than others to turnover and profit reductions in this regard.

Supply and the profile of vendors

There has been a strong pipeline of pharmacy transactions and acquisition opportunities throughout Ireland in 2016. Vendors clearly feel market conditions are favourable which is supported in large part by the prices currently being achieved. Pharmacy acquisition opportunities to date in 2016 have come from three sources:

1. Allcare sales
2. Distressed sales
3. Independent operators who are either retiring or reorganising their businesses

Allcare's Project Orion is interesting. Given the fragmented nature of the market in this

country we are unlikely to see a process of this type again for many years, particularly given the fact that by selling these shops in a piecemeal fashion to independent operators, Allcare will fragment the market further still.

The appetite of lenders and prospective purchasers for these pharmacies will provide an instructive temperature check for the market at large.

With the Allcare sales process due to complete in 2017 the principal source of future supply will come from independent operators many of whom are now willing to sell again as the country climbs out of recession and prices improve.

Demand and the profile of purchasers

Demand remains strong. Prospective purchasers have recognised that scale will be important in the years ahead and many are attempting to build networks that can deliver better performance in terms of procurement, operating efficiencies and brand impact.

Scale concerns aside, pharmacy based investments represent a relatively safe bet for established



operators with funds to invest and a proven track record of success.

In large part prospective purchasers can be categorised as follows:

1. First time buyers
2. Independent operators (non-groups)
3. Joint venture partners
4. Groups and chains

While Allcare's Project Orion will lead to fragmentation it is likely that the market will consolidate over the next three to five years with more mini groups of 6 to 10 shops emerging. As these groups look to build scale it will be interesting to see if mergers occur between complimentary businesses that may be able to develop meaningful synergies and an estate with broader geographical reach and appeal.

What is currently interesting, however, is the increase in the number of joint venture partnerships we are seeing, with established pharmacists providing funding and know-

how to younger individuals in exchange for an equity stake in the new business.

Activity

With liquidity returning to the market, and clarity emerging on the sustainability of profit margins, we have noted year on year growth in transaction volumes. According to PSI statistics, there were 95 transfers of pharmacy ownership in 2015 against 42 in 2014. This trend continued into 2016 with 85 transfers recorded between 1st January and 30th June 2016. While ownership transfer are not always the result of a pharmacy sale, with internal reorganisations and PSI administrative updates also triggering transfer events, these figures do suggest an increase in activity.

As a counter point to transaction volume growth, the greenfield pharmacy expansion rate seems to be in decline with 9 net new openings (new openings after closures) in the first six months of 2016 compared to 28 net new openings in 2015. With that said pharmacy greenfield expansion has defied expectation for some time now and it is too early to call whether the noted rate of

decline is a blip or the early signs of an actual slowdown.

Funding

AIB, Ulster Bank and Bank of Ireland remain very supportive of pharmacy expansion with each bank committing time and resources to better understand the changing legislative landscape and profit model. The positive appetite of the banks towards the sector provides the conditions necessary for existing operators and first time buyers to fund transactions.

There is competition again in the lending market, which is good for prospective purchasers as they try to secure the best deal in terms of rate, security, debt cover and term. This environment is also good for vendors and we are seeing fewer deals hit the buffers as a result of delays in bank funding.

In short, if pharmacy expansion funding applications make sense the bank are supportive.

Outlook

With many legacy challenges now overcome the general outlook for the sector is positive. While profit pressures

and an element of uncertainty remain, most operators have come through the FEMPI years relatively unscathed and many are now focussed on expansion. The market was artificially quiet between 2009 and 2014 but while the current positivity persists the number of pharmacy transactions will continue to grow.

Like any other sector of our economy community pharmacy is susceptible to wider economic forces. Currently unquantifiable considerations such as Brexit will undoubtedly have an impact in the months and years ahead but once the economy remains on an even keel we expect continued growth in the Pharmacy Acquisitions Market.

If you would like to discuss the matters raised in this article, please contact Stuart Fitzgerald of Fitzgerald Power at 051-870152 or sfitzgerald@fitzgeraldpower.ie

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Regulatory Science appointment for former IMB Head

The Board of Regulatory Science Ireland (RSI) has announced that Dr Pat O'Mahony has been appointed Executive Director. Currently Dr O'Mahony is Deputy Secretary General and Head of Governance and Performance at the Department of Health. He will take up office at RSI from January 2017. Prior to his joining the Department of Health, Dr O'Mahony held the position of Chief Executive with the Health Products Regulatory Authority [formerly the Irish Medicines Board] for 12 years. He was Chairman of the European Medicines Agency for seven years from 2007-2013.

RSI is a newly established initiative to foster an environment through which relevant research, training and communication creates a cohort of Irish based Regulatory Science experts to further strengthen the value proposition of Ireland as an attractive location for the health products sector to flourish. It is a collaborative alliance bringing together interested parties and institutions across the medicines and medical devices industries, academia, regulators, and other state agencies including IDA Ireland and Enterprise Ireland in pursuit of an integrated Irish response to global

Regulatory Science initiatives that are beneficial to patients.

Welcoming the appointment, Ms Anna Bradley, Chair of RSI, stated that Dr O'Mahony brought a depth of regulatory and industry experience that would be hugely beneficial to the RSI's strategic direction and future success.

"Dr O'Mahony will be our first Executive Director and the Board is delighted to have secured someone of his calibre and acumen. We wish him every success to advance our organisation from its infancy



Executive director of regulatory science ireland, Pat O'Mahony

to the next important stage of its development. The Irish life sciences sector is of great significance for patients and the economy; the RSI will play an important role to nurture the future strategic development of this rapidly expanding and evolving

sector as well the high skilled individuals working within it."

Dr. O'Mahony is a Chartered Director and holds a Master's Degree in Veterinary Medicine and an MBA degree from the Michael Smurfit Graduate School of Business, UCD.