Mergers in the community pharmacy sector?

75% of pharmacies in Ireland are still owner-managed or held by groups with six or less pharmacies. The other 25% of pharmacies are owned by the bigger chains, with six or more shops. In the UK, it's the exact opposite with 75% of pharmacies owned by the large chains and the balance held by owner/managers. Some consolidation has been seen with the development of some large international chains expanding in Ireland. Smaller indigenous chains or buyer groups have also been active in the acquisitions markets.

In the past, pharmacies were profitable and valuations were therefore high. Indeed, some may say that in many cases, with the benefit of hindsight, that valuations were excessive. Prices were driven by a flood of cheap money to fund these acquisitions, all of which came to an abrupt end. Then, with little or no bank finance, economic uncertainty and some pharmacy operators in 'intensive care' needing 'financial surgery', valuations fell to a level that was not appealing to potential vendors. All of this led to a big slowdown in mergers and acquisitions. Is this about to change?

At JPA Brenson Lawlor we track the pharmacy sector very carefully. Since 2009 we have seen big changes, including the elimination of mark-ups on State-sponsored dispensing schemes, FEMPI legislation claw-backs, the introduction of prescription charges, introduction of price competition on private prescription fees and the ongoing rollout of reference pricing – all of this against a very unhappy economic backdrop.

Comparing a pharmacy income in 2009 with today, we estimate that the cumulative financial cost from the HSE-led changes alone has been in excess of €5 per item being dispensed. For an average pharmacy dispensing circa 40,000 items per annum, the cumulative impact on bottom line profitability has been circa €200,000 per annum. It's tough trying to make money in pharmacies.

In order to survive, pharmacists have had to take a hard look at how they operate and take action to hang on to their businesses. They have already slashed overheads including their own remuneration, other staff costs, rents and general overheads. While real savings have been and continue to be achieved, the reality is that large elements of the overheads in a pharmacy are fixed and cannot be meaningfully reduced. Some other overheads reductions were temporary but are now reverting to original levels and some overheads are actually starting to increase, reducing the benefit of savings achieved.

Between 2009 and 2012, most pharmacies saw increases in the number of items they dispensed. Greater volume even at a lower margin partially made up for a drop in profitability. But this growth in item numbers has started to fall again. This is due to new pharmacies opening, the introduction of prescription charges and/or the elimination of some items from the HSE schemes. To address this latest fall, ever the entrepreneurs, pharmacists have started to offer services previously only available through GP practices and continue to focus on their own buying patterns. But the pressure remains and merging of pharmacy businesses may be one solution to the economic pressures.

In our experience, mergers provide significant advantages including more dynamic management, increased purchasing power and overheads rationalisation, less reliance on hard-to-get bank funding and, in some instances, the opportunity for owners to step back from the day-to-day management of the pharmacies. But, of course, there can be downsides as well, including tough decisions to be taken to get to mutually acceptable merger terms including ownership interests, roles and owner remuneration post-merger, the valuation of a pharmacy, difficulties around quantifying the expected benefits associated with a merger, financial and non-financial and, of course, having to let go of control.

It's worth noting here that the growth of buying groups in the Irish retail pharmacy sector, especially those with enhanced services such as branding, marketing support, retail support, etc., provide their members with many of the benefits of a merger but the option to retain sole ownership of their pharmacy.

With a merger there are so many issues to consider such as whether the pharmacies are similar in terms of goods and services, are they of similar size, the numbers of items being sold, is this increasing or decreasing, staffing levels, the turnover, gross margin and profitability being achieved, staffing levels, operating procedures and even what remuneration have shareholders been taking from the business? On top of this, you have to check if buildings are freehold or leasehold, whether there are bank borrowings against them or the businesses, right down to whether the IT systems are compatible? At the operating level there could be incompatibilities depending on which wholesalers are being used and there could be cosmetic and other agency agreements, but the aim would be to find out where all the synergies lie?

And then there's the 'arm-wrestling' element to any merger, trying to match off promoters' skills, how long they may see themselves staying with the business, what they value their businesses and their shareholding at (and what their balance sheets look like) so an agreement can be reached as to the ownership percentages, remuneration and role of the existing shareholders/supervising pharmacists – tricky issues but ones that are not impossible to overcome.

Assuming some agreement is reached, the next stage is to complete a detailed business plan for the merged entity. This will include detailed financial and cashflow projections to try to see what profitability a merged business could achieve. And of course, there has to be a full legal and financial due diligence completed by both parties – often carried out by advisors independent of the merging parties. If it all stacks up, and if a shareholders' agreement can be signed, then a merger can proceed to completion. Despite what may appear to be a complex process, we've found that the entire process should take no more than three months. During the process there would be plenty of visits to accountants, solicitors and other advisors and these costs should be factored into the merger consideration.

Outcomes can be positive and happy, once certain goals are achieved. The first thing to do is to have a chat with your advisor about what those goals are for you and your pharmacy.

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