

Bank of Ireland ROI Sectors Team

Pharmacy Sector 2018 Outlook

The community retail pharmacy sector remains a fragmented market, though consolidation is increasing with a number of smaller local groups and single retail pharmacists seeking acquisitions.

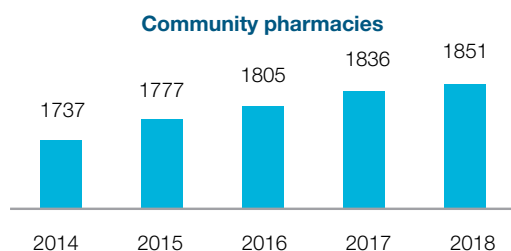
Health Sector 2018 Review

Ireland's population – People are living longer

- ▶ People are living longer; as can be seen in the changes in the population aged over 65, rising by 102,174 to 637,567; an increase of 19.1% since 2011.
- ▶ In the 2018 Budget projections, health spending increased from €14.6bn (2017) to €15.3bn (2018) with 15% of this budget projected to be spent on demand led medication reimbursement.
- ▶ With an ageing population and associated polypharmacy (use of multiple medications by patients), the State's prescription bill has the potential to increase substantially if current policies on prescribing continue.

Community Pharmacy Market

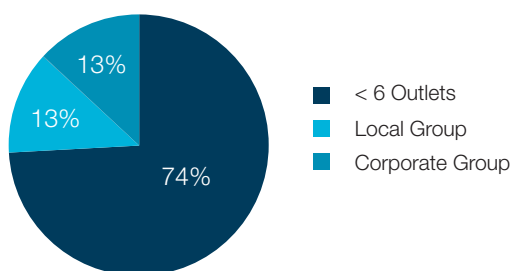
- ▶ The Irish Pharmacy sector remains a fragmented market, though consolidation is increasing.
- ▶ Despite industry predictions since 2014 that the numbers of retail pharmacies would reduce, these have risen.
- ▶ In 2017, there was 26 new (net) pharmacy openings compared with 22 net new openings in 2016; this includes pharmacies in Primary Care Centres (PCCs).
- ▶ The number of retail pharmacies has increased by 6.6% from 1,737 in 2014 to 1,851 retail pharmacies in June 2018.



Community Pharmacy Ownership Profile

- ▶ Unlike other European countries, c. 74% of pharmacies are owner managed or held in groups <6 with 13% in local groups and the remaining 13% belonging to corporate groups.

Community Pharmacy Ownership Profile



State Reimbursement

- ▶ The State is involved at each level of the pharmacy supply chain and pays for c. 80% of all medicines with > 50% of pharmacy income coming from State reimbursement schemes.
- ▶ Over recent years (2009-2017) the Government has made a number of changes including reduced payments for medicine reimbursement and cuts to fees and mark-ups.

Below is a summary of the changes introduced:

| | |
|---|--|
| FEMPI July 2009 | <ul style="list-style-type: none"> ▶ Introduction of Regressive Scale for dispensing fees ▶ Reduced wholesale mark-up from 17.66% to 10% |
| FEMPI Mar 2011 | <ul style="list-style-type: none"> ▶ Reduced wholesale mark from 10% to 8% ▶ Reduced DPS mark-up from 50% to 20% |
| Health Act (May) 2013 | <ul style="list-style-type: none"> ▶ Generic substitution ▶ Standard pricing for interchangeable medicines |
| FEMPI July 2013 | <ul style="list-style-type: none"> ▶ 20% DPS mark-up scrapped ▶ Reimbursement model of professional fee introduced |
| IMB August 2013 | <ul style="list-style-type: none"> ▶ List of interchangeable medicines published |
| HSE Reference Pricing introduced Nov 2013 | |
| Phased Dispensing 2017 | |

- ▶ These changes have resulted in State savings of over €3bn.

Key Trends

- ▶ The 2009 – 2016 Primary Care Reimbursement Service (PCRS) data shows that as a result of an ageing population and associated polypharmacy there was an 8.3% increase in the number of items dispensed under the various State Schemes. However, as a result of changes to the State Reimbursement, the overall amount paid by the State to pharmacists has reduced by 30%
- ▶ Reports from the Central Statistics Office (CSO) demonstrate, between 2014 and 2017, that while the volume of retail sales of Pharmaceutical, Medical and Cosmetic Items increased by 17.8%, the value only increased by 9.6%.
- ▶ These trends demonstrate the impact of the economic downturn, the demographic changes and the State savings on individual pharmacies.
- ▶ A reduction in both the cost per item and the mark-up and fee per item alongside an increase in the number of items dispensed together with the increased volume of retail sales has resulted in an increased volume of work with an overall reduction or plateau of income for individual pharmacies.

Market Activity

Retail Pharmacies

- ▶ Transactions market was artificially quiet from 2014 to 2016 as a result of reduced turnover and consequent lower EBITDA margins. However, as consumer confidence returned and no further State reimbursement reductions were introduced, turnover and profitability increased slightly in 2017 and has remained relatively stable.
- ▶ 2017 and 2018 has seen sales activity increase with the sale of the Unipharm pharmacies and a number of pharmacists retiring.
- ▶ In 2017, there were 89 Change of Ownerships recorded by the Pharmaceutical Society of Ireland (PSI); down from 143 in 2016.
- ▶ Pharmacies are trading at 4 – 6 times stabilised EBITDA.
- ▶ Pharmacy chain Sam McCauley, backed by private equity from Carlyle Cardinal Ireland, announced that it has embarked on a €50m acquisition spree to double its number of outlets from 30 to 60.
- ▶ Paddy Hickey also unveiled expansion plans, with the group looking to double in size over the next five years. The expansion starts with two new stores opening in Cork, bringing the total to 36, with an expectation to have a total of 60 outlets by 2022.

Primary Care Centres (PCCs)

- ▶ There are currently 114 PCCs operational with 31 locations under construction or development, at advanced planning or underway for design / planning purposes and 44 PCCs at an early planning stage.
- ▶ Increased competition from PCCs pharmacies has led to reduced turnover and profitability for some pharmacies in some smaller towns.

Bank of Ireland ROI Sectors Team

Pharmacy Sector 2018 Outlook

A positive outlook for resilient operators with consolidation continuing in the retail pharmacy sector. However, headwinds in relation to staffing and increasing costs.

Health Sector Outlook

Market

- ▶ Continued growth in the healthcare sector is projected given the Central Statistics Office (CSO) forecasts and the recent review of demand and capacity which outlined the demographic and non-demographic drivers of healthcare demand.
- ▶ Projected population increases are greatest for older ages. The population aged 80 and over is projected to increase by c.130k from 2015 to 2030.
- ▶ The projected growth in people aged >80 forecast over the next 15 years will have a profound impact on the demand for healthcare services with the average cost of care for older persons being two to three times that of the average Irish person.
- ▶ Polypharmacy increases with age and the Economic and Social Research Institute (ESRI) projected demand for medicines dispensed under public schemes to increase by c.35% from c.76m items to >115m by 2030.
- ▶ In addition, by 2030, the ESRI project that pharmacy consultations will increase by c.22% to >7.5m consultations.

Business Model:

- ▶ The sector has worked through the challenges it has faced in recent years, particularly Government cuts in reimbursement rates on State run schemes and increased competition in the form of supermarket multiples and large international pharmacy chains.
- ▶ Pharmacy owners have proven themselves to be resilient and have adapted to changes in their business model; joining purchasing or symbol groups, increasing their on-line presence, and offering additional value add services such as vaccinations and weight management. This has resulted in improving EBITDA margins.

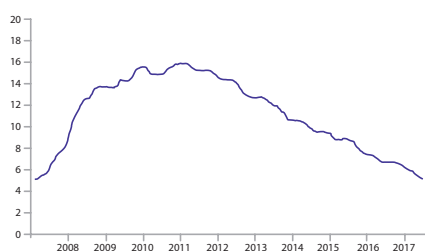
Community Retail Pharmacies

Potential Headwinds

Health Sector Staff:

- ▶ The sustained decrease in unemployment rates continues to add pressure for recruitment in the health sector.

Seasonally adjusted unemployment ROI



- ▶ Central Bank of Ireland recently announced that wages are expected to “gain further momentum”, increasing by an average of 3.3% for 2018 and 2019.
- ▶ The Living Wage Technical Group, an independent group backed by unions and social justice bodies has pegged a new ‘living wage’ rate at €11.90 an hour.
- ▶ A shortage of pharmacist locums, particularly outside urban areas, has been reported.
- ▶ These labour force pressures have resulted in average wage costs increasing over the last 18 months from c.18% of turnover to c.20% of turnover.
- ▶ We project that labour costs will continue to rise as the challenges of recruiting and retaining staff continues.

Costs:

- ▶ Rental costs: The Society of Chartered Surveyors Ireland (SCSI) projects a 6% increase in prime retail rents in Dublin.
- ▶ We have seen a marginal increase in rent costs for retail pharmacies to c.5% of turnover.

Health Products Regulatory Authority (HPRA):

- ▶ The HPRA outlined the potential regulatory challenges and risk to the medicines supply chain as a consequence of Brexit.
- ▶ Brexit could contribute to an increased risk of medicines shortages in Europe and an increase in the cost of medication.
- ▶ This may result in further State intervention to reduce overall costs.

Funding Activity: What we expect to see

Retail Community Pharmacy:

- ▶ Increased sales activity after an artificially quiet 2015/16 market with smaller groups looking to scale and consolidate.
- ▶ Private investors will continue to scale up in the sector.
- ▶ Private equity may be a feature for new entrants seeking to bridge the equity gap.
- ▶ Well located efficient pharmacies will continue to achieve price multiples of 4-5x adjusted EBITDA.
- ▶ Resilient operators who successfully weathered the challenges and focused on improving their business model, will continue to build customer base and increase profits.

Bank of Ireland

Retail Community Pharmacy:

- ▶ Bank of Ireland, as the leading lender to the healthcare sector, has the proven financial capabilities and appetite, combined with comprehensive sectoral expertise together with a full range of products including growth finance and working capital to support our pharmacy customers to adapt and thrive.



Hilary Coates

Head of Health Sector

Hilary joined Bank of Ireland as Head of Health and Life Sciences in 2014 and has supported retail pharmacists to grow and scale their businesses. She held previous roles as Head of Healthcare Regulation in HIQA, Principal Consultant at PA Consulting, Patient Safety Advisor at World Health Organization and Head of Healthcare Business in Allianz Ireland. Her extensive senior clinical and business experience gives her a unique understanding of clinical, regulatory and financial aspects of healthcare. Hilary holds an MBA from UCD, post graduate qualifications in Risk Management, Corporate Governance, and Regulatory Crime and is currently studying for a Professional Diploma in Business and Executive Coaching at UCD Michael Smurfit Graduate Business School.

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Sources: Central Statistics Office; Pharmaceutical Society of Ireland; Primary Care Reimbursement Service; Health Products Regulatory Authority; Health Service Executive; Department of Health.