

Pharmacy and Drug Stores

INDUSTRY OVERVIEW

Drug stores continue to reinvent themselves as one-stop wellness centers and convenient shopping alternatives to supermarkets and mass merchants. Most recently, major chains CVS, Walgreens, and Rite Aid have invested in digital tools such as smartphone apps and telehealth services. The industry continues to be impacted by the conversion of branded drugs to generics, and increased penetration of specialty drugs and industry-wide declines in insurance reimbursement rates.



TREND TRACKER

Pharmacy NOLVs	Consistent
Pharmacy Sales Trends	Increasing ↑
Pharmacy Gross Margin	Mixed ⇕
Script Valuation	Consistent
Front End NOLVs	Consistent
Front End Sales Trends	Increasing ↑
Front End Gross Margin	Mixed ⇕
Front End Discounting	Mixed ⇕

NOLVs: Most NOLVs have remained relatively consistent.

Sales Trends: Sales trends have been generally increasing, depending on the company, type of product, and sales region.

Gross Margin: While many retailers in the industry have experienced improving gross margins due to the transition to lower-cost generic drugs, generic drug prices have been increasing, which has pressured gross margin. In addition, declining reimbursement rates continue to pressure gross margin.

Script Valuation: Script values have remained relatively consistent.

KEY INDUSTRY DRIVERS

- **Generic drug price increases:** Generic drug prices have been on the rise due to several factors, including higher costs of raw materials and reduced competition. Some generic drug prices have increased as part of business strategies to increase profits, which many have labeled price-gouging and sparked outrage from both consumer groups and Congress. For example, after Daraprim, a generic used to treat infections, was acquired by a pharmaceutical startup in September 2015, the company raised the price overnight from \$13.50 to \$750 per tablet. Additionally, after another pharmaceutical company purchased the tuberculosis drug Cycloserine in August, it raised the price from \$500 to \$10,800 for 30 pills. However, the increase was rescinded after significant public backlash. While some pharmacies have been able to pass these increases on to customers, others have had to absorb the costs, to the detriment of gross margin.
- **Tobacco:** CVS' front-end comparable store sales continue to be impacted by its decision to stop selling tobacco in late 2014; however, this will be anniversaried soon, which should result in more normalized sales. In addition, sales are more profitable, as tobacco sales generally achieve lower gross margin. Should other retailers follow CVS' lead, similar declines in front-end sales could be seen.
- **In-store services:** Drug stores continue to blur the line between retail store and health provider by investing in in-store services, such as medical screenings, nutrition and health education, medication therapy management, and telehealth programs. In addition, several states have passed laws allowing pharmacists to administer more types of vaccines and immunizations.
- **Specialty drugs:** Pharmacy retailers are offering an increased assortment of high-cost specialty drugs used to treat rare and chronic conditions. While a boon to pharmacy retailers' bottom line, industry advocates have questioned the rapid rise of specialty drug prices and patients' and insurers' ability to afford them.

SALES TRENDS

The following table illustrates the quarterly comparable store sales trends for CVS, Walgreens, and Rite Aid (Represents the most recent fiscal quarter sales reported):

	Most Recent Quarter	Prior Quarter	Two Quarters Ago	Three Quarters Ago
CVS				
Pharmacy	4.1%	4.2%	5.5%	4.8%
Front End	(7.8%)	(6.1%)	(7.2%)	(4.5%)
Total	0.5%	1.2%	1.6%	2.0%
Walgreens				
Pharmacy	7.0%	9.7%	8.1%	7.8%
Front End	1.6%	2.5%	1.5%	1.3%
Total	6.3%	6.9%	5.7%	5.4%
Rite Aid				
Pharmacy	2.8%	3.9%	5.7%	7.2%
Front End	0.3%	0.6%	2.0%	1.6%
Total	2.1%	2.9%	4.5%	5.4%

Note(s): The most recent quarter for CVS ended June 30, 2015; Walgreens ended May 31, 2015; and Rite Aid ended August 29, 2015.

OUTLOOK

Sales are expected to increase due to continued demand for prescription drugs, clinic visitations, and general merchandise, particularly as the rate of uninsured Americans continues to decline. These gains may be slightly offset by declines in profitability as a result of higher drug costs and reduced reimbursement rates. Retailers may focus on private label sales to increase gross margin.

Monitor Information

GA's Retail Monitor highlights key industry drivers within the retail sector and how they relate to GA's valuation process and current trends in recovery values. As the retail industry is impacted by consumer spending patterns and various macro and microeconomic factors, timely and accurate information is essential. GA strives to contextualize important indicators to provide a curated perspective of the market for our clients' needs. Such indicators include general industry trends, comparable store sales trends, gross margin changes, and discounting activity. Any comparable store sales illustrated in this monitor reflect figures as they have been reported by public retailers. The methodology for calculating comparable store sales may vary by company.

GA welcomes the opportunity to make our expertise available to you in every possible way. Should you need any further information or wish to discuss recovery ranges for a particular segment, please feel free to contact your GA Business Development Officer using the contact information shown in this and all *Retail Monitor* issues.

GA's *Retail Monitor* provides a brief overview highlighting specific sectors of the retail industry. The information contained herein is based on a composite of GA's industry expertise, contact with industry personnel, liquidation and appraisal experience, and data compiled from a variety of well-respected sources believed to be reliable. GA does not make any representation or warranty, expressed or implied, as to the accuracy or completeness of the information contained in this issue. Neither GA nor any of its representatives shall be liable for use of any of the information in this issue or any errors therein or omissions therefrom.

Experience

GA is one of the largest liquidators of retail inventory and has been involved in a variety of liquidations, ranging from the disposition of excess inventory and the closing of underperforming stores, to full-scale liquidations of national retailers with hundreds of stores. GA has experience with full and partial liquidations of companies throughout a variety of retail sectors, some of which are detailed below:

Target Canada	Cache	Office Depot/Max	Circuit City
Macy's	Fashion Bug	Mervyns	Tower Records
Fortunoff	Frederick's of Hollywood	Eddie Bauer	RadioShack
Linens 'N Things	Naartjie	Whitehall Jewelers	Borders
Jo-Ann Fabrics	Boot Town	A&P	Movie Gallery

These experiences, in addition to numerous others, provide GA with valuable insight into the market trends and the consumer response that can be expected in a liquidation. They give us an understanding as to recovery values that can be achieved for retailers within these industries. In addition to this liquidation experience, GA has worked with and appraised numerous retailers, including industry leaders within each sector. While our clients remain confidential, GA's extensive list of appraisal experience includes:

- Major regional grocery store chains including one with a store base of upwards of 800 and net sales in excess of \$10.0 billion, as well as smaller local grocery store retailers and pharmacies.
- Regional and independent pharmacy retailers, including those specializing in durable medical equipment, specialty drugs, and holistic medicines.
- Several e-commerce and multi-channel retailers, as well as flash sale websites and auction websites. In particular, GA has appraised 71 of the top 500 e-commerce companies as reported by *Internet Retailer*.
- Numerous retailers of apparel and accessories, including major department store retailers and a variety of specialty retailers that are found in malls throughout the country.
- Leading off-price retailers of apparel and accessories, including major national and regional chains.
- Retailers of consumer electronics, including smaller, more localized chains, as well as regional, national, and international retailers with close to 4,500 store locations.
- Major national and regional discount and dollar stores, including one of the country's largest chains, with over 10,000 stores.
- Leading book retailers, including one with over 700 store locations and sales of upwards of \$4.5 billion.
- Sporting goods retailers that specialize in a number of products, including those for outdoor sports, recreational ball sports, hunting, camping, and fishing, and a variety of other equipment for outdoor enthusiasts.

In addition to our internal personnel, GA maintains contacts within the retail industry that we utilize for insight and perspective on recovery values.

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