

Pharmacy Market Review 2019



INTRODUCTION

2019 has been a challenging year for the pharmacy sector as contractors have continued to grapple with cash flow squeezes, resulting from the Category M Claw Back implemented from November 2018 through to March 2019.

Alongside this there have been supply and pricing issues which also impacted operating efficiencies - now sadly seen to be an all too regular occurrence.

Early in 2019, the PSNC announced that it had entered detailed negotiations with the Department of Health and Social Care (DHSC), in relation to the global funding settlement for the year 2019/2020, as well as an overhaul of the pharmacy contract. Many had repeatedly called for more certainty through the delivery of a long-term settlement, rather than the year-to-year negotiations which had become commonplace. Whilst it was anticipated that the results of these negotiations would be announced no later than October 2019, a keenness not to see the process derailed by the Conservative Party leadership contest and the impending 31st October Brexit deadline, the Five-Year Deal was announced in late July, ahead of the Parliament's Summer recess.

Contractor feedback has been one of guarded welcome, in part comforted by confirmation that the global funding sum will remain the same for the next five years, but also cautious, due to

the number of changes and yet unidentified services for which some of the monies will be allocated.

In our Review we have again analysed the NHS year to April 2019, as well as the 'Five-Year Deal' that was set out in the DHSC's Community Pharmacy Contractual Framework for 2019/20 to 2023/24.

Despite the pressure contractors have seen and the uncertainty of the contract negotiations earlier in the year, competitive bidding, strong applicant demand and positive deal activity have remained constant themes of the market.

In Scotland, contractors have benefited from a more collaborative arrangement with the Scottish Parliament, resulting in additional funding to support the pharmacy network. Contractors should benefit further from the new extended Minor Ailment Scheme (MAS), likely to be called 'Pharmacy First' and due to be rolled out from April 2020.

Historically, in contrast to England, there has been a lower turnover of pharmacies in Scotland as contractors enjoy a relatively stable remuneration environment. However, over the last 12 months transactional activity has increased significantly as owners take advantage of the premium prices being paid.

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Trends in Dispensing Activity



KEY DISPENSING AND SERVICE ACTIVITY

AVERAGE ITEMS DISPENSED

As with previous years, the average dispensing volume over 2018/19 remained relatively static at 7,362 items per pharmacy. Pharmacies in health centre settings continued to outperform the dispensing trends in other settings - some 58% more than pharmacies in community or high street settings and 46% above the national average in England.

Large multiples continue to lead the way, on average dispensing 8,094 items per pharmacy, albeit slightly lower than in the previous year. Similarly, corporate operators saw their average dispensing volumes fall with medium and small multiples as well as independent contractors witnessing slight increases.

A comparison of dispensing data for the NHSE financial year versus prior years

MONTHLY AVERAGE ITEMS

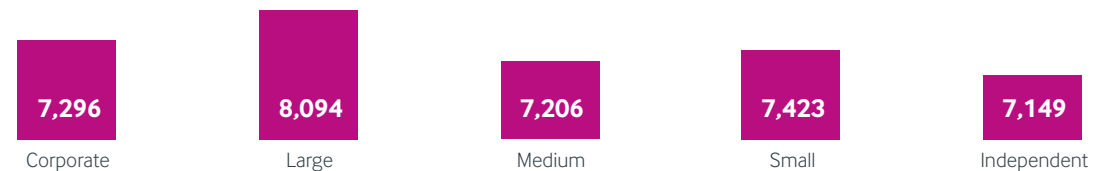
OVERALL



SETTING 2018/19



OPERATOR SIZE 2018/19



KEY DISPENSING AND SERVICE ACTIVITY

EPS ACTIVITY

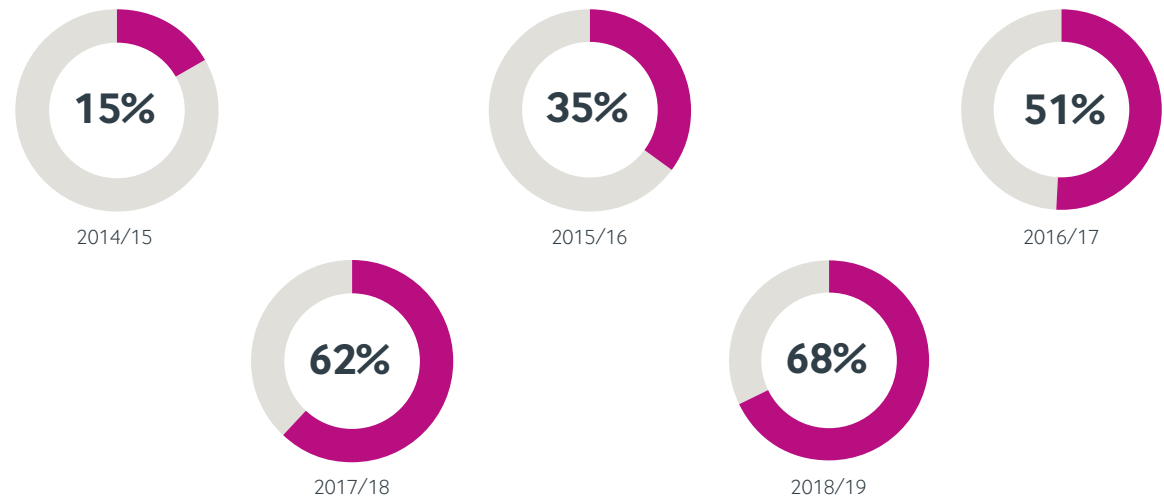
As in previous years, the number of items dispensed through EPS continued to rise with over 68% of items prescribed electronically. Pharmacies in community or high street settings (standard) continued to benefit the most, albeit the percentage increases seen were consistent across all pharmacy settings.

With EPS Phase 4 currently being piloted and tested, assuming this is successful, its future roll-out will see EPS prescribing being sent by default regardless of whether a patient nomination had been made or not. Such a roll-out will inevitably see EPS activity rates increase even further.

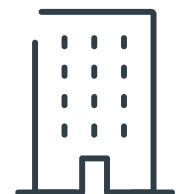
Proportion of items being dispensed through the Electronic Prescription Service (EPS)

EPS PROPORTIONS

OVERALL



SETTING



69%
Standard

65%
Integrated

66%
Health Centre Adjacent

KEY DISPENSING AND SERVICE ACTIVITY

SERVICE ACTIVITY

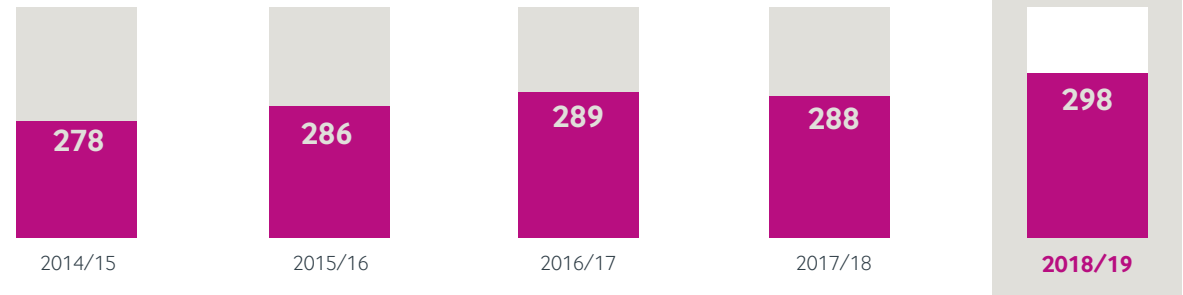
The opportunity to mitigate some of the squeeze in cashflow through the delivery of MURs and NMS continued to see mixed results. For MURs, whilst there was an overall average increase in activity, it remained at only 75% of the full 400 quota available to each pharmacy. Although relatively small increases, those which improved the most were pharmacies in corporate or small multiple ownership. Independent contractors' performance posted the smallest improvement, on average only undertaking seven more MURs per pharmacy than in the prior year.

With the service of MURs to be phased out over the next two years, contractors will be keen to understand in what form the monies saved will be reinvested and how accessible they will be to shore up income.

Similarly, NMS activity saw only nominal increases, with pharmacies operating in large multiple ownership continuing to perform more NMS - more than double that undertaken by pharmacies in small multiple ownership.

In the new Five-Year Deal, the DHSC has outlined its intentions to expand NMS over the next five years, in turn looking to add further conditions to those already covered.

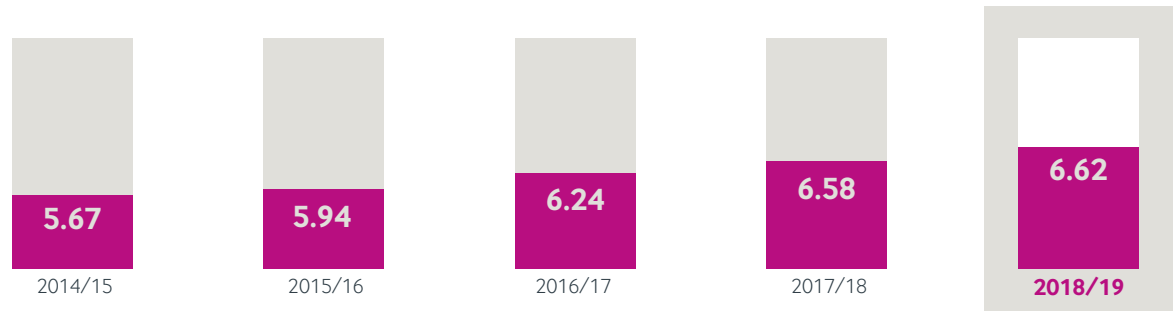
ANNUAL AVERAGE MURS (MEDICINE USE REVIEWS)



BY OPERATOR TYPE (2018/19)



MONTHLY AVERAGE NMS (NEW MEDICINE SERVICE)



BY OPERATOR TYPE (2018/19)

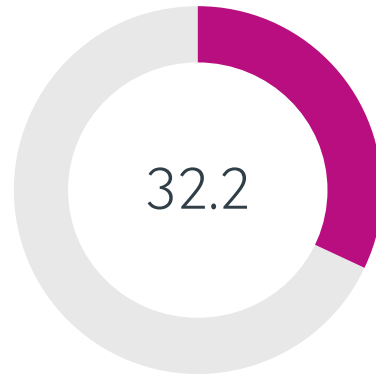


Key Trading Performance Indicators

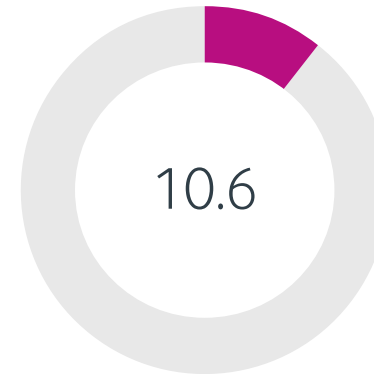


THE PHARMACY MARKET

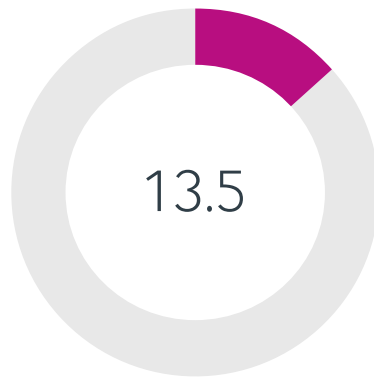
A snapshot of average trading metrics for pharmacies across the UK (%)



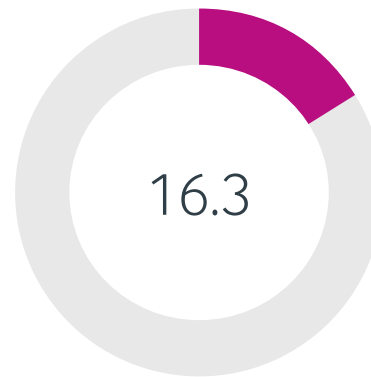
Gross profit margin



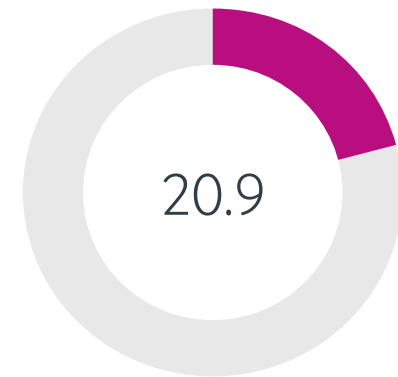
EBITDA margin



Staff costs margin



**Staff costs margin including
Locum costs**



**Locum costs as a % of staff
costs margin**

The Five-Year Deal



THE FIVE-YEAR DEAL

The global funding sum has been fixed at £2.592 billion for each of the next five years

Analysis of The Community Pharmacy Contractual Framework for 2019/20 to 2023/24: supporting delivery for the NHS Long Term Plan

On 22nd July 2019, the DHSC released its Five-Year Deal for the pharmacy sector.

In delivering a long-term funding settlement the DHSC has fixed the global funding sum at: £2.592 billion for each of the next five years. Whilst offering certainty to contractors and therefore receiving a cautious welcome, in real terms, when considered in context with the Retail Price Index (RPI) this equates to a reduction in income of circa 5%.

In outlining the proposed changes, several services remain as a 'work in progress' and will be developed and rolled out over the five-year settlement. More importantly, the plan confirms the eventual phasing out of the Establishment Payments, with a reduction of £41million for the current financial year. Whilst the precise end date for the Establishment Payment is uncertain, it is anticipated that it will finally cease by 2021/22.

MURs will be decommissioned over the next two years, requiring contractors to embrace the drive towards the new service-led contract.

The Single Activity Fee (SAF) as outlined in the DHSC's circular, this is set at an assumed £1,315 million per annum, although is to be assessed each year. It is anticipated that the funding will reduce over the course of the settlement as new technology and transformation is enabled.

The Retained Medicine Margin is set at £800 million per annum.

£97 million per annum will be allocated to other Activity Related Payments to include professional fees as set out in 'Part IIIA' of the NHS Drug Tariff.

The Pharmacy Access Scheme (PhAS) will be funded at £24 million per annum, though the DHSC has signposted that it will look to improve and update the Scheme.

The New Medicines Service will continue with funding of £23 million per annum. However, the DHSC intends to introduce additional conditions covered by the service over the course of the settlement. In doing so, it has suggested that the level of allocated funding for the service may increase.

The Deal introduces a time-limited service for the testing of Hepatitis C, albeit only a nominal sum for the financial years 2019/20 and 2020/21. If the service is extended, any future funding will be derived from the 'Unallocated Funding for clinical services/transformation funding'.

In addition to the funding confirmation, the DHSC launched a consultation on a series of drug reimbursement reforms. Under the current reimbursement scheme many operators have found it difficult to effectively manage cashflow and finances. The consultation gives all contractors the opportunity to express their concerns and to provide feedback which may help re-shape the reimbursement scheme.



Source: DHSC – The community Pharmacy Contractual Framework for 2019/20 to 2023/24: supporting delivery for the NHS Long Term Plan

KEY DEALS

In the last 12 months we have valued, appraised or sold c. 700 pharmacies with a combined value in excess of

£515m

A selection of recent sales brokered by Christie & Co

Longton Pharmacy, Lancashire

- C. 17,060 average items
- Turnover c. £1.9m pa
- Exceptional fit-out



J&A Reekie Chemists, Ayrshire

- Two pharmacies sold separately
- 14 offers received in total
- C. 126% of asking price achieved

Walford Mill Pharmacy, Dorset

- Health centre pharmacy
- C. 7,000 average items
- Opportunity to develop premises



Papworth Pharmacy, Cambridgeshire

- Integrated pharmacy
- Average 8,000 items
- Over a dozen offers received



The Green Pharmacy, Essex

- Busy village pharmacy
- Close to health centre
- Average 16,700 items

Fulham Pharmacy, London

- High street pharmacy
- Average 4,500 items
- Affluent London suburb



VALUATION & ADVISORY ACTIVITY

A summary of the high profile valuation and advisory activity carried out by Christie & Co



LLOYDS BANK

164 commercial Red Book Compliant valuations with a combined value of £205m.

allTM cures pharmacy

Ongoing valuation advice provided to help with the continued expansion of the group.

 **Santander**

111 commercial Red Book Compliant valuations with a combined value of £128m.

WESLEYAN BANK

we are all about you

Continued professional advice provided in support of lending within the pharmacy sector.



Valuation of the portfolio to help with the continued expansion of the group across Scotland.



Christie & Co's Consultancy team has provided buy side due diligence advice in connection with several of the most notable recent corporate transactions.

PRICE TRENDS

As highlighted in our Business Outlook Review earlier this year, we saw the average price increase slow from

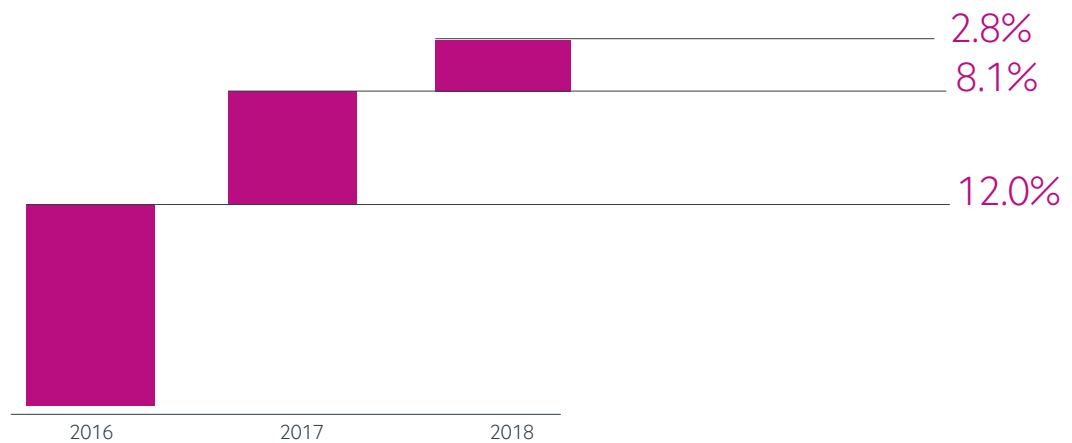
8.1% to 2.8%

for the prior year. At the same time, we witnessed more smaller pharmacies come to market, in part attributed to many multiple operators who sought to dispose of non-performing or marginal assets. In addition, many independents took the opportunity to exit the market on the back of strong values being achieved.

Continuing this theme, 2019 has seen a significant increase in pharmacies coming to market, albeit matched by buyer appetite with over 140 sales agreed in the first eight months of the year.

As a result, appetite has continued to support EBITDA multiples ranging from 7.5x to 10x for standard hours contracts. In Scotland, where the sector enjoys a more settled funding landscape, scarcity of stock combined with strong operating profits contribute to stronger EBITDA multiples, often achieving 9x to 11x for high quality pharmacies.

MOVEMENT IN AVERAGE PRICES, YEAR ON YEAR



UK PHARMACY MARKET COMPOSITION

INDEPENDENT OWNERSHIP BREAKDOWN

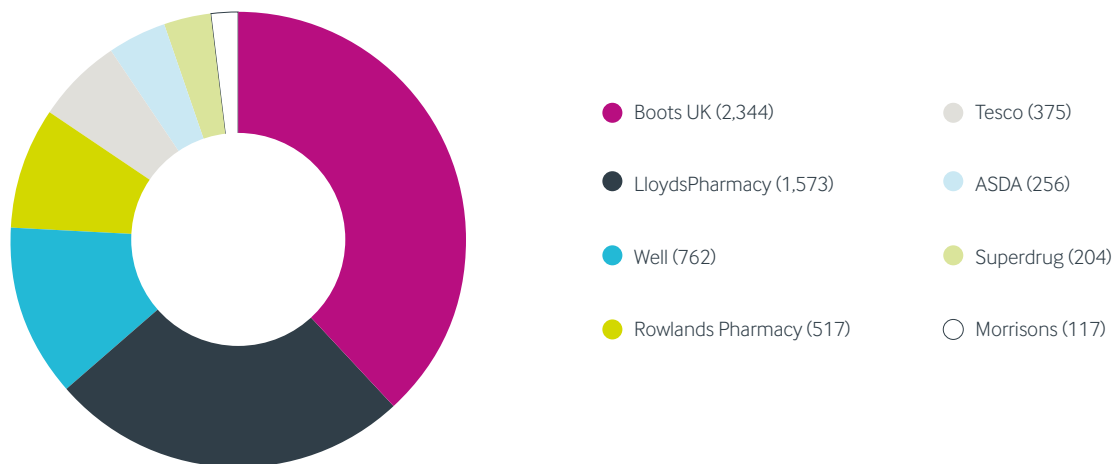
PHARMACIES



OPERATORS



CORPORATE AND SUPERMARKET BY OWNERSHIP



BUYER DEMAND

Similar to 2018, the majority of demand has been from first time buyers and small independents as the larger operators, in the main, concentrated on consolidating their existing estates. In doing so, some larger operators offered for sale smaller, more marginal pharmacies from their estates, attracting interest from first time buyers.

With the various challenges the sector has had to endure in the last 12 months, we saw a slight reduction in pharmacy applicants as some preferred to shy away from the market whilst awaiting the outcome of the PSNC and DHSC's funding negotiations. Despite this the DHSC's subsequent announcement of its Five-Year Deal in July, it seems to have done nothing to remove the competitive appetite that is such a feature of the sector.

With a database of over 6,100 registered applicants, 81% are first time buyers, whilst circa 10% are existing independent contractors. The remaining 9% is made up of multiple operators.

Despite the clear weighting of the database in favour of first time buyers, this appetite only resulted in 32% of deals being agreed to this applicant set, whilst c. 54% of deals were agreed to multiple operators.

90%
of applicants on our national database are either first-time buyers or independent contractors

54%
Year-to-date c. 54% of sales have been agreed to multiple operators

CHRISTIE FINANCE

How has the Five-Year Deal affected the lending market

Whilst banks still see pharmacy as a positive funding opportunity, some have inevitably adapted their lending parameters in recognising the changes and challenges the sector has endured over recent years.

Many will request that more extensive due diligence is undertaken to support lending applications. As a result, it is imperative that operators and prospective purchasers develop sound business plans, not only capturing a business's existing trading performance/profile but also outlining opportunities for growth with the implementation of new services etc.

Initial reaction to the recently published Five-Year Deal has been one of cautious optimism, as the sector sees its global funding sum fixed at the current level for the next five years. However, with the new funding settlement highlighting various changes over the period of the Five-Year Deal it is important that operators and buyers looking for funding fully understand the impact that the settlement may have on a business's future performance.

As with other sectors, where banks have existing funding arrangements with multiple and group operators, many closely monitor trading performances. Should these edge close to agreed covenants they may look to the operator to consider restructuring of the debt either through an additional cash injection, disposal of non-performing assets or potentially considering other refinance opportunities.

An update on the current lending market for pharmacies

An increase in demand for flexible funding

Over recent years, we have seen an increase in the demand for flexible funding in the pharmacy sector. Operators have witnessed funding cuts and regulatory developments impacting upon business in various ways, leading to a rise in the solutions available in order to alleviate cash flow pressures. Unsecured loans and equipment finance have proven popular throughout the sector. Their flexibility provides operators the opportunity to cover unexpected bills, fund store improvements or even assist with the acquisition or relocation of a pharmacy, all at competitive rates.

Christie Finance has a specialist team of pharmacy finance brokers who, through their thorough understanding of the sector, can offer a variety of funding solutions to support both operators and buyers alike.

Christie Finance secured in excess of

£46,000,000

of finance for the medical sector over the last 12 months

CONTACTS

CORPORATE SERVICES

Our specialist Pharmacy team offers a full range of services across the pharmacy market, these include:

- Acquisition & Disposals Advice
- RICS Accredited Valuations for Loan Security
- Expert Witness / Dispute Resolution
- Landlord & Tenant Services
- Benchmarking Reports
- Strategic Business Advice / Market Mapping
- Commercial Due Diligence
- Market Research

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Medical Valuation Team

We have a team of **Chartered Surveyors and RICS Registered Valuers** dedicated to the pharmacy sector. Working closely with our transactional colleagues we are able to draw on current market sentiment and comparable evidence.

With access to comprehensive market data, we are in a unique position to benchmark both business performance and pharmacy values, ensuring reports and professional advice are always well researched and well informed.

We are recognised as leading valuers by all the high street banks, as well as most of the other specialist lending institutions. Much of the work we undertake is for loan security, accounts and balance sheet, acquisition, disposal, dispute resolution, statutory compensation and taxation purposes.



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Christie & Co's medical consultancy proposition is unique, with the team advising on some of the largest transactions in the sector whilst providing bespoke research to a number of operators, investors and private equity companies.

Key strengths include our market leading level of proprietary data, sophisticated analytic tools and our granular understanding of the pharmacy sector. The latter is reinforced by a close working relationship between consultancy and colleagues within our pharmacy brokerage and valuation teams, enabling clients to benefit from high quality advice combining data with in depth market insight.

Our team consists of a high-calibre group of professionals with an extensive and diverse range of analytical, financial, operational and property-based skills.

We specialise in tailoring bespoke outputs to meet client needs. Typical types of assignment include commercial, research and property due diligence, market analysis, market studies and business planning.

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Christie Finance is a specialist commercial finance broker, helping pharmacy operators and purchasers to develop and grow their businesses for over 40 years. As an independent broker, Christie Finance are not tied to any particular lender, knowing which ones to approach to source the commercial finance required.

As a member of the Christie & Co Network, Christie Finance are known and respected throughout the pharmacy sector, and their clients are taken seriously by lenders; whether it is a first time buyer, an existing operator, or a client looking to release capital for a new venture, they guide clients through the process to secure competitive funding.

A network of six regional hubs across the UK enables the team to combine a local knowledge with national insight. A local Christie Finance pharmacy specialist will deal personally with every aspect of a clients' commercial mortgage application, or in securing fast and flexible finance, offering a straightforward solution to covering costs of key pharmacy practice investment or acquisition.

All funding is subject to status.

RCC Business Mortgages plc, trading as Christie Finance, is authorised and regulated by the Financial Conduct Authority. Our Firm Reference number is 709982. Not all types of business we undertake is authorised and regulated by the Financial Conduct Authority. Christie Finance operate as an intermediary and are not a principal lender.

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