

Pharmacy and Drug Stores

INDUSTRY OVERVIEW

Drug stores are repositioning themselves as convenient shopping alternatives to supermarkets and mass merchants, offering one-stop shopping for pharmacy and wellness products, general merchandise, seasonal goods, and consumables. Overall, industry sales and gross margin continue to be impacted by the conversion of brand name drugs to lower-priced generics, as well as 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; however, some companies have been experiencing declines due to the region and product mix.

Gross Margin: Gross margin has been mixed. While many retailers in the industry have experienced improving gross margin due to the transition to lower-cost generic drugs, others have noted that generic drug prices have increased, which has pressured gross margin.

Script Valuation: Script values have remained relatively consistent.

KEY INDUSTRY DRIVERS

- **Generic drugs:** Low-cost generic drugs boost gross margin at the expense of sales. However, generic drug prices have been on the rise due to several factors, including higher costs of raw materials and compliance fees and reduced manufacturing competition. While some retailers 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 were significantly impacted by its decision to stop selling tobacco in September 2014. It has estimated that excluding the impact of tobacco, its comparable store sales would have increased slightly, as opposed to declining in its most recent quarter reported. Should other retailers follow CVS' lead, similar declines in front end sales could be seen.
- **In-store services:** Drug stores are offering a variety of in-store services, from medical screenings and basic care to nutrition and health education, medication therapy management, and immunizations.
- **Consumables:** Consumables boost customer traffic and front-end sales. Drug stores have expanded and enhanced consumable offerings, and have worked to improve private-label merchandise. These initiatives have paid off, as *Supermarket News* recently ranked CVS as the 11th-largest grocery retailer in the U.S. based on sales. Walgreens and Rite Aid also ranked high on the list.
- **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. Express Scripts recently announced it would not cover Sovaldi, a \$1,000 per pill Hepatitis C drug, and instead would cover a cheaper, less effective treatment.

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	5.5%	4.8%	5.0%	3.8%
Front End	(7.2%)	(4.5%)	(0.4%)	(3.8%)
Total	1.6%	2.0%	3.3%	1.4%
Walgreens				
Pharmacy	8.1%	7.8%	6.3%	5.8%
Front End	1.5%	1.3%	2.2%	2.0%
Total	5.7%	5.4%	4.8%	4.3%
Rite Aid				
Pharmacy	7.2%	5.6%	4.6%	3.5%
Front End	1.6%	1.1%	0.0%	(0.7%)
Total	5.4%	4.1%	3.1%	2.1%

Note(s): The most recent quarter for CVS ended December 31, 2014; Walgreens ended November 30, 2014; and Rite Aid ended November 29, 2014.

OUTLOOK

Drug stores will continue to take advantage of increased demand for prescription drugs and clinic visitations as a result of the Affordable Care Act, as well as demands for wellness products and general merchandise.

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 those with pharmacies within, including one with a store base of close to 400 and net sales of nearly \$8.0 billion, as well as smaller local grocery store retailers.
- 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 74 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.

Appraisal & Valuation Team

BUSINESS DEVELOPMENT



Mike Marchlik
National Sales & Marketing Director
mmarchlik@greatamerican.com
(818) 746-9306



Ryan Mulcunry
Executive Vice President - Northeast Region, Canada & Europe
rmulcunry@greatamerican.com
(617) 692-8310



David Seiden
Executive Vice President, Southeast Region
dseiden@greatamerican.com
(770) 551-8114



Bill Soncini
Senior Vice President, Midwest Region
bsoncini@greatamerican.com
(312) 777-7945



Daniel J. Williams
Managing Director, New York Region
dwilliams@greatamerican.com
(646) 381-9221



Drew Jakubek
Managing Director, Southwest Region
djakubek@greatamerican.com
(972) 996-5632



Jennie Kim
Vice President, Western Region
jkim@greatamerican.com
(818) 746-9370

OPERATIONS

John Bankert
President
jbankert@greatamerican.com
(781) 429-4054

David Triompo
Managing Director, Consumer Products
dtriompo@greatamerican.com
(781) 429-4067

Tracy Foohey
Associate Director
tfoohey@greatamerican.com
(781) 429-4059

Matthew Gins
Project Manager
mgins@greatamerican.com
(818) 746-9386

Nicole Hines
Project Manager
nhines@greatamerican.com
(781) 429-4072

Kipp Visi
Associate Project Manager
kvisi@greatamerican.com
(312) 777-7957

Louise Shimazu
Associate Project Manager
lshimazu@greatamerican.com
(818) 746-9339

About Great American Group

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Headquarters

21860 Burbank Blvd. Suite 300 South
Woodland Hills, CA 91367

800-45-GREAT

www.greatamerican.com