

Pharmacy and Drug Stores

INDUSTRY OVERVIEW

Pharmacy and drug store industry sales and gross margin continue to be impacted by the conversion of brand name drugs to lower-priced generics, albeit at a slower pace. In order to boost sales, pharmacies are focusing on additional ways to drive revenue, including offering specialty drugs and in-store services. In order to capitalize on the millions of newly insured customers as a result of the Affordable Care Act, pharmacy retailers are repositioning themselves as one-stop health and wellness centers, which was evidenced recently by CVS's landmark decision to stop selling tobacco products.



TREND TRACKER

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

- **Specialty drugs:** Specialty drugs are extremely high-cost medications for rare or complicated conditions, and are expected to account for 50% of drug industry revenue by 2018. The increased prescribing and dispensing of specialty drugs have boosted many pharmacy retailers' sales. Due to their complexity, only a few generic versions, or biosimilars, have been approved.
- **Generic Drugs:** Low-cost generic drugs have boosted pharmacy retailers' gross margin. In addition, since the "patent cliff" of 2012, when several blockbuster drugs lost patent protection, the number of branded drugs going off patent has declined. Many believe that generic drug prices may be bottoming out, with several retailers noting some generic drug prices have increased in recent months. As retailers have anniversaried against the patent cliff, sales have started to improve.
- **In-store services:** In order to increase sales and customer traffic, drug stores are offering in-store services such as medical screenings and basic care, nutrition and health education, medication therapy management, as well as immunizations. In particular, many of the companies GA has appraised over the last year have noted that immunization services have boosted sales.

SALES TRENDS

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

CVS	Most Recent Quarter	Prior Quarter	Two Quarters Ago	Three Quarters Ago
Pharmacy	5.0%	3.8%	6.8%	5.7%
Front End	(0.4%)	(3.8%)	(1.9%)	(1.0%)
Total	3.3%	1.4%	4.0%	3.6%

Note(s): The most recent quarter for CVS ended June 30, 2014.

The following table illustrates the monthly comparable store sales trends for Walgreens and Rite Aid.

	Sept. '14	Aug. '14	Jul. '14	Jun. '14	May '14	Apr. '14	Mar. '14
Walgreens							
Pharmacy	11.3%	5.0%	7.6%	11.3%	5.5%	7.3%	8.0%
Front End	1.7%	1.4%	1.1%	1.3%	2.6%	8.2%	(3.4%)
Total	7.9%	3.7%	5.2%	7.5%	4.4%	7.6%	3.5%
Rite Aid							
Pharmacy	6.3%	5.2%	6.0%	5.4%	5.0%	5.2%	3.5%
Front End	2.3%	1.1%	1.5%	0.9%	0.5%	4.7%	(5.0%)
Total	5.1%	3.9%	4.6%	3.9%	3.5%	5.0%	0.7%

OUTLOOK

Pharmacy and drug stores are well-positioned to take advantage of increased healthcare demands in the near future, particularly as the influx of newly insured Americans as a result of the Affordable Care Act is expected to increase demand for prescription drugs and boost clinic visitations.

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:

A&P	Linens 'N Things	Circuit City	Tower Records
Fortunoff	Fashion Bug	Mervyns	Payless Shoe Source
Jo-Ann Fabrics	Borders	Whitehall Jewelers	Movie Gallery
Ritz Camera	Boot Town	Eddie Bauer	Macy's

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 73 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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About Great American Group

Great American Group is a leading provider of asset disposition solutions and valuation and appraisal services to a wide range of retail, wholesale and industrial clients, as well as lenders, capital providers, private equity investors, and professional services firms. GA also offers the *UK Retail Monitor* via its subsidiary, GA Europe Valuations Limited.

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