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A Shot in the Arm: Chemists Seek Wider Scope

IBISWorld explores recent merger and acquisition activity in the Dispensing Chemists industry.

Pressure on profit as a result of pricing regulation has been a key driver of M&A activity in the industry

As in many other sectors, the online sphere has proved disruptive to the operations of traditional dispensing chemists, with online-only pharmacies posing a growing threat. External competition, particularly for over-the-counter products, from supermarkets and discount health and beauty stores has weighed on margins, whilst the industry's financial performance has also been hit by new regulation and tight NHS budgets. In response to this, companies have engaged in M&A, with some of the most prominent acquisition activity involving firms outside the scope of traditional pharmacy operation, and many successful examples of M&A activity have been conducted by large foreign conglomerates, helping to expand dispensing chemists' market reach and service scope.

Pressures on profitability have been a key factor encouraging M&A activity. Industry operators receive medicine reimbursement payments for each dispensed prescription. To control growing costs, the Department of Health introduced the Pharmaceutical Price Regulation Scheme (PPRS) in 2014, a profit cap and penalty system on the sale of branded pharmaceuticals. The imposition of PPRS has encouraged the dispensing of lower-price, lower-margin generic drugs over branded versions to avoid PPRS payments. This has ultimately constrained revenue and profitability, encouraging consolidation activity.

Consolidation has in fact been the recurring theme in the story of the industry's largest operators. In 2014 Walgreen acquired the remaining 55% of Boots for £3.1 billion. This has allowed Boots to expand its reach, and has also provided a strong financial backing for investment in other markets. The third largest player in the industry was established in 2014, when Bestway Holdings acquired the Co-operative Group's pharmacy business for £620 million. These pharmacies were rebranded under the Well brand, and Bestway has continued to expand its position through a series of acquisitions, adding the small Care4U and Ideal Healthcare Ltd pharmacy chains to its portfolio in 2016. In September 2016, the second largest operator, Lloyds, acquired all 281 Sainsburys' pharmacies, although it did have to sell 12 pharmacies in order to satisfy the Competition and Markets Authority. However, illustrative of the funding issues present in the core pharmacy service offering, Lloyds announced the closure and divestment of 190 stores in October 2017, citing changes in government policy, funding cuts and the Apprenticeship Levy as key factors behind this decision.

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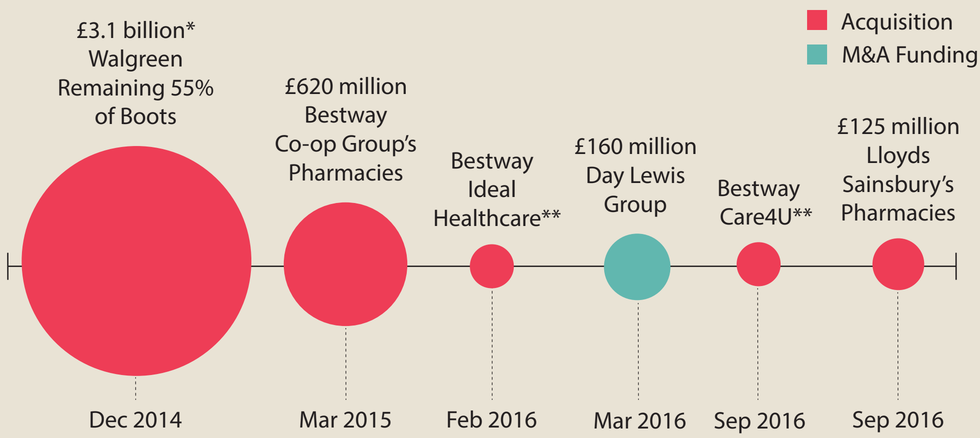
Smaller firms have also sought growth through M&A activity, as a market still composed of a significant number of independents continues to coalesce. In March 2016 Chemist chain Day Lewis Group secured £160 million in M&A funding from banking partners in order to achieve its aims of owning more than 400 pharmacy sites across the United Kingdom by 2021. In July of the same year, the group acquired Community Pharmacies (UK) Ltd, taking its total pharmacy portfolio to over 300.

The consolidation trend is not confined to bricks-and-mortar operations. In July 2016, Pharmacy2U and ChemistDirect.co.uk announced a £40 million merger, in a move following the opening of Pharmacy2U's new £3.5 million dispensing hub in Leeds, the first of its kind in the United Kingdom. This facility can dispense one million prescription items a month, and is testament to the strength of the online pharmacy sector and the importance of investment. The merger was backed by £10 million in investment from the Business Growth Fund and is expected to serve a customer base of 1.5 million, also including online doctor consultation services, clinical advice from pharmacists. and over 6,000 health and wellbeing products.

Over the coming five years, M&A activity is expected to remain prominent. Without diversified operations, smaller operators are likely to struggle with falling funding and turn to either mergers with similar sized firms to increase economies of scale or be acquired by incumbent operators. Indeed, Bestway chief executive, Zameer Choudrey, stated following the Co-op acquisition that the fragmentation of the pharmacy sector provides 'a lot of room for us to grow, not just organically but also via acquisition.' The ageing of the population and other demographic trends, such as the rising incidence of obesity, are expected to continue to support revenue opportunities, but ongoing competitive pressures and the shift to the online sphere will force streamlining activity, as well as a diversification of services. Whilst industry services will remain vital, external investment and a broadening of scope is expected to be important in maintaining good industry health.

M&A activity in the Dispensing Chemists industry



*Converted from US Dollars **Undisclosed sum. Part of a £200 million expansion plan

SOURCE: IBISWorld

IBISWorld Industry reports used in this special report:

G47.110	Supermarkets in the UK
G47.730	Dispensing Chemists in the UK
R92.000	Gambling & Betting Activities in the UK