



DRUG STORES & PHARMACIES

CURRENT TRENDS

- Analysts expect industry revenue to increase at an annualized rate of 2.7% through 2025, despite rising competition from big-box and e-commerce retailers.
- The 2021 average comparable store sales trend is 2% for the three largest U.S. drug store retailers, a decrease from 4.1% in 2020 when nationwide lockdowns led to increased front-end sales of cleaning supplies and over-the-counter products.
- Industry revenue benefits from an aging population. An estimated 727 million people were aged 65 and older worldwide in 2020, and forecasters predict this number will more than double by 2050.
- Fulfillment innovation is shaping pharmacy deliveries.

PROJECTED VALUES (12-MONTH OUTLOOK)



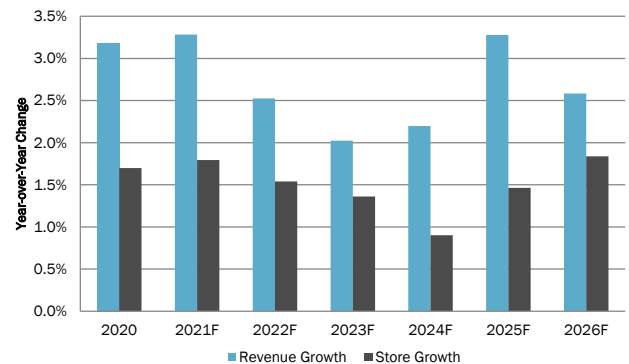
APPROXIMATE NET RECOVERY ON COST

45%-55%
front-end

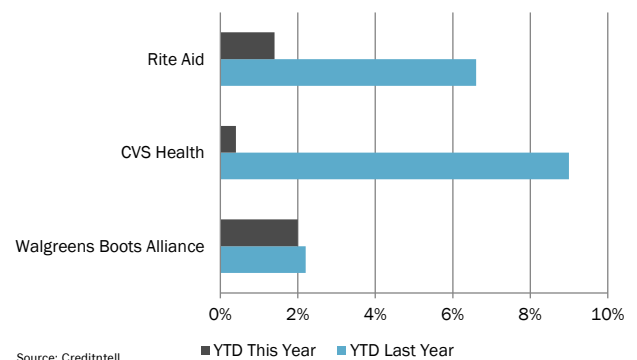
95%-99%
pharmacy

65%-75%
combined

INDUSTRY REVENUE AND STORE COUNT



MAJOR RETAILER COMPARABLE STORE SALES



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PANDEMIC POSITIVES: The National Pharmacist Workforce Study, a survey of more than 5,000 pharmacists conducted every five years, found pharmacists became more active than ever in their traditional roles as health care and pharmaceutical counselors and advisors in 2019. This trend accelerated during the pandemic as pharmacists became trusted providers in their local communities. Drug stores and pharmacies filled an integral role for consumers during the worst days of the pandemic, a trend that has continued in 2021 as drug stores and pharmacies become vaccine hubs worldwide.

Major drug store retailers performed well in 2020; Walgreens, CVS and Rite Aid posted annual increases of 1.6%, 5.6% and 1.1%, respectively, in comparable store sales. During the first quarter of 2021, CVS continued with an overall slightly positive same-store sales increase of 0.4%, driven by a 4.1% pharmacy sales increase. However, there was an 11.4% drop in front-end sales during this same period. This decrease occurred because cold and flu season was weaker and there was less demand in 2021, compared to the March 2020 lockdown. Additionally, the company's first quarter segment results noted a slower than anticipated return of front-end traffic, urban market recovery uncertainty and vaccine hesitancy. Recently, there was a 30% decrease in demand for vaccines.

Similarly, Rite Aid's same-store sales for the first quarter increased 1.4% with a pharmacy revenue increase of 8.2%. Meanwhile, Rite Aid experienced an 11.5% decline in front-end sales compared to 2020.

More recently, Walgreens' comparable store sales increased 6.4%, including an 8.4% increase in pharmacy and a 1.7% increase in front-end sales, for the three-month period ending May 31, 2021. This performance is more in line with retail industry expectations for a return to normalcy in the second half of 2021.

PHARMACY FULFILLMENT INNOVATION: Walgreens Boots Alliance is taking a page out of traditional retailers' fulfillment playbooks by adding micro-fulfillment locations to support its prescription shipping demand. By the end of 2022, the company plans to have 11 micro-fulfillment centers across the U.S. Two centers in Phoenix, Arizona, and Dallas, Texas, are already in operation, supporting more than 500 Walgreens pharmacies.

In January 2021, Walgreens announced it acquired a majority stake in New York-based pharmacy automation provider iA that operates the centers. During the pandemic, pharmacists became an integral part of community networks as they educated and supported consumers. However, the added duties were a strain with the increase in customer traffic and prescription volume.

According to Walgreens, "The iA mission to further modernize and automate the prescription fulfillment process aligns with our priority to create the pharmacy of the future, reducing operational costs and enabling pharmacists to spend more time providing valuable healthcare services to patients such as vaccinations, diagnostic testing and medication management."

If the popularity of online shopping and the escalating demand for delivery options across every retail sector is any indication, this is just the beginning

of a wider network of direct fulfillment services for the pharmacy segment.

RETAIL OUTLOOK: Drug store revenue benefits from an aging population. An estimated 727 million people were aged 65 and older worldwide in 2020, and forecasters predict this number will more than double by 2050. The United Nations Department of Economic and Social Affairs predicts 20% of the U.S. population will be aged 65 and older by 2030. Globally, this number will increase from 9.3% in 2020 to 16% in 2050 indicating a positive growth outlook for the industry.

While the industry experienced moderate revenue growth amid the pandemic, research firm IBISWorld projects the rebounding economy will strengthen industry performance, resulting in steadier revenue growth over time. Therefore, analysts expect U.S. drug stores' revenue to increase at an annualized rate of 2.7% through 2025, despite rising competition from big-box and e-commerce retailers.

VALUATION OUTLOOK: National drug store and pharmacy chains largely benefited from increased sales in 2020 as essential retailers allowed to remain open during lockdowns. However, many independent and smaller drug store chains struggled or closed as consumers filled prescriptions and purchased non-pharmacy items online.

Gordon Brothers anticipates a stable to strong valuation trend in front-end inventory and expects no change for pharmacy recoveries.

LIQUIDATION METHODOLOGY DRIVES VALUE: A complete disposition sale in the drug store segment includes a twofold approach in which the front-end inventory is sold separately from the pharmacy inventory. Prior to the sale of the front-end inventory, the pharmacy inventory is sold to competitors in conjunction with the sale of the customer prescription (script) files. Appraisers typically assume the pharmacy inventory recovers at a rate of 95% to 99% of cost, barring open packaging and expired or nearly expired product.

It is imperative the script files and pharmacy inventory sale occur prior to or at the outset of a going-out-of-business sale. Running the script files and pharmacy inventory sale after the liquidation sale is underway would lower the value of the script files, as customers may go to new pharmacies for their medications, reducing the number of transferable prescriptions. The net impact would be a reduction in total value for the prescription list, which is typically a key component of drug store disposition values.

Pharmaceutical manufacturing and sales are heavily regulated by the Food and Drug Administration since health and safety risks are associated with prescription drug usage. As a result, pharmacies are vulnerable to prescription drug recalls. Gordon Brothers recommends monitoring pharmaceutical products in the appraisal of a company's inventory, as any significant recalls would negatively affect recovery values.

Script file values depend on the number of active files and the number of competitors willing to purchase. As part of the liquidation process, the agent contacts local pharmacy competitors to gauge interest in the pharmacy inventory and script files. The script auction occurs with the prescription inventory sale to winning bidders at negotiated prices.

Pharmacy sales are excluded from the capacity of the front-end liquidation model in the appraisal analysis so as not to overstate front-end sales capacity. Gordon Brothers typically sees front-end net recovery rates ranging from 40% to 50% on cost. Lenders with clients in this industry should partner with an experienced appraiser to understand front-end and pharmacy inventory values as well as customer script files to ensure advance rates remain within realistic ranges.

The Expert: Becky Goldfarb



Bringing over 15 years of experience in the disposition and valuation of retail and consumer products, Becky Goldfarb oversees all aspects of retail asset valuations. Prior to that, Becky was responsible for the financial analysis of retail dispositions across all industry sectors. Read her full bio [here](#).



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