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Walgreens to Buy Rite Aid in US$17.2 Billion Deal

(Sources: Press Releases, an article prepared by MICHAEL JOHNSEN and published by Drug Store News; Drug Channels Institute)

Walgreens Boots Alliance and Rite Aid – the number 3 chain drugstore in the US – announced on October 27 that they have entered into a definitive agreement under which Walgreens Boots Alliance will acquire all outstanding shares of Rite Aid for US$9 per share in cash, for a total enterprise value of approximately US$17.2 billion, including acquired net debt. The purchase price represents a premium of 48% to the closing price per share on Oct. 26, the day before the agreement was signed. Walgreens Boots Alliance is highly focused on building a differentiated in-store experience for health, wellness and beauty, and this combination will help accelerate Rite Aid's own efforts toward that end, the companies said. Once the acquisition closes, Walgreens Boots Alliance plans to further transform Rite Aid's stores to better meet consumer needs.

"Today's announcement is another step in Walgreens Boots Alliance's global development and continues our profitable growth strategy," Walgreens Boots Allliance executive vice chairman and CEO Stefano Pessina said. "In both mature and newer markets across the world, our approach is to advance and broaden the delivery of retail health, wellbeing and beauty products and services. This combination will further strengthen our commitment to making quality healthcare accessible to more customers and patients. Our complementary retail pharmacy footprints in the U.S. will create an even better network, with more health and wellness solutions available in stores and online. Walgreens Boots Alliance will provide to Rite Aid its global expertise and resources to accelerate the delivery of integrated frontline care, and to offer innovative solutions for providers, payers and other entities in the U.S. healthcare system. Finally, this combination will generate a stronger base for sustainable growth and investment into Rite Aid stores, while realizing synergies over time."

The boards of directors of both companies have approved the transaction, which is subject to approval by the holders of Rite Aid's common stock, the expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and other customary closing conditions. The transaction is expected to close in the second half of calendar 2016.

"Joining together with Walgreens Boots Alliance will enhance our ability to meet the health and wellness needs of Rite Aid's customers while also delivering significant value to our shareholders," Rite Aid chairman and CEO John Standley said. "This transaction is a testament to the hard work of all our associates to deliver a higher level of care to the patients and communities we serve. Together with Walgreens Boots Alliance, the Rite Aid team can continue to build upon this great work through access to increased capital that will enhance our store base and expand opportunities as part of the first global pharmacy-led, health and wellbeing enterprise."

In Brief . . .

- **McKesson** reported a 10% increase in revenues (to US$48.8 billion) and a 19% increase in adjusted earnings per diluted share (to US$3.31) for its 2nd quarter ended September 30th. For the first half of the fiscal year, McKesson generated cash from operations of US$1.3 billion, and ended the quarter with cash and cash equivalents of US$5.4 billion. The company also repurchased nearly US$500 million of its common stock, repaid US$498 million in long-term debt, had internal capital spending of US$274 million and paid US$114 million in dividends in the first half.
- **AmerisourceBergen** reported a 13.7% increase in revenue, to US$136 billion, for its fiscal year ended Sept. 30. Adjusted diluted earnings per share from continuing operations were US$4.96, an increase of 24.9% over the prior fiscal year. The company's 4th quarter revenue was US$35.5 billion (up 12.3%), reflecting an 8% increase in **AmerisourceBergen Drug Corporation** revenue, and a 24% increase in **AmerisourceBergen Specialty Group** revenue with Pharmaceutical Distribution revenues increasing 10% in the quarter to US$34 billion.
- **Celesio's** group revenue increased 5.5% to €10.7 billion / US$11.6 billion and its adjusted earnings before interest and tax (EBIT) grew 17.8% to €235 million/US$255.6 million for its first half ended September 30th. Revenue in the Consumer Solutions division – the pharmacy business – was €2.1 billion/ US$2.3 billion, up 17.5%, and revenue in the Pharmacy Solutions division – the wholesale business – was €8.6 billion/ US$9.35 billion, up 2.9%, in the period.
- **Cardinal Health** reported a 17% increase in revenue, to US$28.1 billion, for its 1st quarter of fiscal 2016. Non-GAAP diluted earnings per share attributable to Cardinal Health (EPS) were US$1.38 (+38%) in the quarter and non-GAAP operating earnings increased 30% to US$737 million. Pharmaceutical

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The transaction is expected to be accretive to Walgreens Boots Alliance's adjusted earnings per share in its first full year after completion. Upon completion of the merger, Rite Aid will be a wholly owned subsidiary of Walgreens Boots Alliance, and is expected to initially operate under its existing brand name, with collaborative decisions being made over time regarding the integration of the two companies, with the ultimate goal of creating a fully harmonized portfolio of stores and infrastructure. Walgreens Boots Alliance expects to finance the transaction through a combination of existing cash, assumption of existing Rite Aid debt and issuance of new debt.

Adam Fein, CEO of Drug Channels Institute, commented on the merger citing four key provisions in the merger documents: (1) The deal must be completed before October 27, 2016. If certain specified circumstances arise, the deadline can be extended to

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Walgreens (cont.) . . .

January 27, 2017. (2) If Rite Aid backs out of the deal, then it owes as much as US$370 million to Walgreens Boots Alliance. (3) WBA could owe Rite Aid a termination fee as large as US$650 million. (4) To get the deal approved, WBA is willing to sell [or close] as many as 1,000 stores, or about 8% of the combined total of 12,700 retail locations. Who will buy those stores? In a Bloomberg Business article, some antitrust lawyers argue that WBA will have to sell the stores to a national player. But Fein sees many more options, including regional chains and wholesaler groups. It may also be possible for other pharmacies to satisfy regulators by buying local prescription records, a.k.a., a "file buy."

With respect to the merits of the acquisition, Fein also stated, "The Rite Aid deal adds even more complexity and opacity to an already complex and opaque global business. Walgreens Boots Alliance operates one of the largest U.S. drugstore chains, the largest European drugstore chain, and one of the largest European drug wholesalers. WBA's reporting of aggregated "synergies" also makes it very hard for investors and outsiders to evaluate the underlying performance of different business segments."

In a separate report, Fein comments that "As Walgreens' current wholesaler, AmerisourceBergen will presumably benefit from additional low-profit, brand-name drug distribution revenue. Any generic sourcing benefits, however, will be captured by WBA, which will likely pay ABC a fee for generic distribution to its stores. The timing of any [wholesaler] volume shift is uncertain. McKesson's deal with Rite Aid extends through March 2019. We don't yet know about termination or change-of-control provisions in their agreement. On yesterday's call, Pessina was non-committal about McKesson's future role."

In the meantime both organizations have reported their most recent financial results. As of October 27, Rite Aid reported same store sales for the most recent 34 week period of US$17.4 billion, an increase of 2.2% over the previous year. Front-end sales increased 0.3% while pharmacy sales increased 0.6%. Pharmacy accounted for 69.5% of total sales and of that amount 3rd party prescriptions represented 97.8%.

Walgreens Boots Alliance reported 4th quarter net earnings of US$26 million compared to a US$221 million loss during the same period last year. Net sales increased almost 50% to US$28.5 billion during the quarter that ended August 31. For the year, on an adjusted basis, the company reported net earnings of US$4.2 billion, up 118% over the previous year with sales of over US$103 billion. Pharmacy represented about 66% of total sales for the year and more than 67% for the 4th quarter. The company's US segment grew its retail prescription market share to 19.1%.

Generic Drugs Reduce Healthcare Costs

(Source: an article prepared by Richard Monks and published by Drug Store News; IMS Institute for Healthcare)

Few factors have played as significant a role in helping curb U.S. health care costs over the past decade as generic drugs, a report released by the US Generic Pharmaceutical Association (GPhA) shows.

The report, prepared for GPhA for the seventh straight year by the IMS Institute for Healthcare Informatics, shows that since 2005, generics have saved US patients US$1.68 trillion. In 2014 alone, the report notes, generic drugs trimmed more than US$254 billion from health care spending. Slightly more than a third of those savings were from generics taken by people over 65.

"This new report reinforces that generic drugs are a critical part of any solution to rising costs for patients, payers and for the entire health care system," GPhA president and chief executive officer said. "Safe, effective and more affordable generic medicines mean increased access for the millions who rely on these life-saving therapies." According to the IMS report, 88% of all prescriptions in the United States are filled with generics. However, these lower-cost alternatives to branded drugs account for only 28% of pharmaceutical spending.

GPhA said these savings are particularly relevant given lawmakers' efforts to find ways to lower the costs of federal and state health programs. The savings that generics can provide federal and state programs are already apparent, the report found, noting that Medicare saved US$76.1 billion in 2014 by using generics. That figure translates into an average of US$1,923 for every person enrolled in the program. For the joint state and federal Medicaid program, the 2014 savings amounted to US$33.5 billion, or US$479 per enrollee. The IMS report also notes that generics provided significant savings across a wide range of therapeutic classes. For example, it says, patients saved US$38 billion by using generics to treat mental health conditions while US$27.9 billion were saved with generic hypertension drugs and US$26.8 billion were trimmed from spending on medications to manage or lower cholesterol levels. "It is evident that annual spending on many medication classes would soar in the absence of generic competition," one of the report's authors, IMS Institute executive director Murray Aiken, said. "This underscores the need to sustain the generic drug industry and actively pursue policies that support or grow, rather than undermine, patient and health system savings from generic drugs."

This year's report marked the first time that IMS has included state-by-state savings from generics in its GPhA report.

In Brief(cont.) . . .

Segment revenues were US$25.1 billion and Medical Segment revenues were US$2.9 billion, representing increases of 19% and 2%, respectively.

- **Pfizer** and **Allergan** are in preliminary "friendly" merger talks, according to reports from the *Wall Street Journal* and *Financial Times* (FT). A deal between the two companies would create the world's largest drug manufacturer with a market capitalization in excess of US$300 billion, exceeding Johnson & Johnson, currently valued at US$277 billion. Allergan is currently selling it's generics business to Teva in a deal which will not be affected by any formal merger decisions, according to both Allergan and Pfizer.
- **AstraZeneca** has opened a new manufacturing and packaging facility in Kaluga, Russia with a total investment of US$224 million. The plant, which has been under construction since 2011, represents the largest foreign investment in the construction of a new pharmaceutical facility in Russia.
- **McKesson Canada** has opened its latest state-of-the-art pharmaceutical distribution center in Trenton, Ontario. The new facility features 500,000 square-feet of warehouse space and 12,700 square-feet of office space, to accommodate its staff of more than 200 employees. The center is also outfitted with a new automation system that helps increase the distribution center's overall productivity and volume of orders.

(Sources: Cardinal Health, Celesio, Drug Store News, Financial Times, IFPMA, McKesson, PRNewswire, Scrip and Wall Street Journal)