

## Drug Store Chains Differ In Pursuing Strategic Deals

Rite Aid is playing catch-up in buying Eckerd and Brooks, while Walgreen and CVS are eyeing specialty offshoots as well as stores

By Brent Shearer

**If the battle against the Wal-Marts of the world has a silver lining, it's that it should make it easier for a deal like Rite Aid's to pass competition tests.**

In the latest indication that economies of scale and changing business models are driving deals in the chain drug store industry, **Rite Aid Corp.** recently cemented a \$2.6 billion deal to buy the Brooks and Eckerd chains from Canada's **Jean Coutu Group Inc.** While the dueling national drug store chains have to grow to compete, drug retailing deals also are being driven by the changing nature of the business.

In fact, John Ransom, Managing Director of health care equity research at Raymond James & Associates, says the drug store industry has many elements of a consumer-oriented business model, rather than being strictly a health care business. He points to **CVS Corp.**'s strategy of emphasizing cosmetics and other consumer products as an indication of this trend. And **Walgreen Co.** has said it will expand its in-store "Health Corner Clinic," which offers patients diagnosis and treatment of routine medical conditions.

Rite Aid's acquisition comes two years after Jean Coutu purchased about 1,500 Eckerd stores, mostly clustered in the northeast and mid-Atlantic states, from **J.C. Penny Co.** The Eckers were added to the 300 New England-centered Brooks drug stores already in the compa-

ny's portfolio.

Part of Jean Coutu's motivation in unloading these properties was that it struggled in integrating the Eckerd stores. In March, it had to renegotiate \$1.7 billion in bank loans. Under this financial pressure, the company wasn't able to follow through on plans to spruce up existing stores and offer a broader range of products.

The deal gives Rite Aid, the No. 3 U.S. drug store chain, an additional 1,858 stores, most of which are on the East Coast, and boosts its total number of outlets to 5,000. CVS has more than 6,100 stores while Walgreen has nearly 5,300 stores.

The acquisition puts into action a plan recently outlined by Rite Aid CEO Mary Sammons to open 800 to 1,000 new stores by 2010 and to evaluate acquisition opportunities for gaining more outlets in key strategic markets.

Drug store chains have been on a buying spree in the last few years. In the industry's largest deal before Rite Aid's Eckerd/Brooks buy, CVS acquired 700 of **Albertson's Inc.**'s stand-alone Sav-on and Osco pharmacies for \$2.9 billion earlier this year.

Walgreen also has been active, exemplifying a trend toward specialized services that parallels the consolidation and



adding of scale in the retailing core. The company bought **Medmark Specialty Pharmacy Solutions** and **C&M Pharmacy**, a Chicago-based specialty pharmacy. And in a departure from its organic growth strategy of developing its own new stores, the company recently acquired regional drug store chain **Happy Harry's Inc.**, which operates stores in Delaware, Pennsylvania, Maryland, and New Jersey.

Meanwhile Walgreen's home care division bought Oklahoma City-based **Canadian Valley Medical Solutions Inc.** in a deal that boosted its home infusion therapy and respiratory services capabilities.

This past summer CVS bagged a deal of its own — **MinuteClinic Inc.**, a chain of 83 health care clinics located in retail stores and other unconventional locations. Sixty-six MinuteClinics are located in CVS stores.

Not all analysts greeted the Rite Aid deal positively. "Rite Aid has no track record of being able to grow revenue and earnings at the stores it already operates, so it's hard to see how they'll change that by adding more stores," Ransom says. He describes Rite Aid as a highly diluted, underperforming company, which has tended to deal with its problems by issuing more stock. It is also highly leveraged.

The company is still dealing with the aftereffects of an accounting scandal in 2000 in which six executives were convicted of inflating earnings by \$1.6 billion.

On the antitrust front, it's unlikely that Rite Aid would face the onerous regulatory review that scuttled its planned acquisition in 1996 of **Revco DS Inc.**, a deal that would have created the nation's largest drug store chain. Revco's stores were later divided up

between Jean Coutu and CVS.

Ten years later, dramatic changes in the market should make Rite Aid's most recent acquisition easier for regulators to green-light. Discount retailers like Wal-Mart and Costco now offer pharmacy services, as do some supermarkets, and Internet sales of drugs also have lessened the anticompetitive power of any single drug store chain.

Competition against huge discounters is adding to industry consolidation pressures. If the battle against the Wal-Marts of the world has a silver lining, it's that it should make it easier for a deal like Rite Aid's to pass competition tests.

While the FTC may require some stores to be divested, deal pros expect the

number of locations with enough overlap to create competition problems to be few.

Adam Epstein, President of Site Analytics, says that one of the deal's synergies is that it would allow Rite Aid to cherry-pick its best store locations and close underperforming ones. Because the locations of the newly acquired stores largely overlap with existing stores, it would be easier to extract cost savings, he adds. He also raises the possibility that by increasing its real estate holdings, the deal could make Rite Aid a more attractive buyout candidate.

Beneath the level of the three megachains, Ransom emphasizes that there are a number of regional players that are ripe for consolidation.

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*Time & Place: 6:00pm Cocktails ~ Madame Tussauds, 234 W. 42nd St.  
8:00pm Dinner & Music ~ BB King Blues Club & Grill, 237 W. 42nd St.*

October 18, 2006:

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*Time & Place: 11:15 - 1:30pm ~ Yale Club, 50 Vanderbilt Avenue*

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