



Pharmacybrands

Pharmacybrands Limited 2010 Annual Meeting Chairman's Address

As this is the first opportunity I have had to speak to a number of you as Chairman of Pharmacybrands, I would like to thank you for the trust you have placed in this business, by investing in it. On behalf of the Board I want you to know that, whether you previously held shares in Life Pharmacy or Pharmacybrands – or both – or whether you purchased post merger, this is now a single company unified in its structure, vision, values and culture.

And it is now a substantial pharmacy business. In the Unichem, Amcal, Life Pharmacy and Care Chemist brands we have the four leading brands in pharmacy in New Zealand. We represent 257 retail outlets operating throughout the country, and we have an ownership interest in 30 of these, as well as in two 50/50 joint venture non-pharmacy outlet stores.

Since we completed the merger the company has been focused on four objectives: concluding the integration of head office functions; achieving the anticipated benefits of the merger in terms of savings from economies of scale; developing strategies to capitalise on the strong position the company now enjoys and establishing a platform for sustainable future growth. I would like to update you on progress on these goals.

The financial results tell part of the story, especially with respect to points one and two regarding the synergies of the merger. In May we reported that, for the twelve months to 31 March 2010, we had achieved a profit of \$3,523,000, an improvement of \$1,814,000 on the corresponding period last year. However, this is impacted by the timing of the merger – being half way through the year - and the way we accounted for it – as a reverse acquisition. A better comparison would be to look at the second half results of both companies. This shows an improvement in second half profit of \$1,361,000. This represents an excellent result, particularly given the difficult trading environment and the considerable team effort required to achieve it while integrating and consolidating critical business functions. It provides clear evidence that the merged company is already beginning to achieve the anticipated benefits from the integration of the two businesses. We believe the annualised, ongoing savings are in the vicinity of \$2 million per annum.

Prior to the merger it would have been fair to describe Pharmacybrands as a franchise company with strong revenues streams but limited assets and Life Pharmacy as company with larger assets but limited revenue streams. Now we have a combination of both: a good asset base and strong revenue streams.





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The third objective was to develop strategies for the future growth of the business. This is obviously not a one off exercise and remains a work in progress. I will cover some of the future business issues a little later.

Finally we wish to ensure that our growth is sustainable. We have a pretty strong balance sheet with approximately \$10 million in cash, and access to further funds. We are in the process of transferring some head office debt to our partnership stores, and we have our staff focused on the “cash is king” philosophy. This is to further strengthen the financial position of your company.

We have made several key staff appointments during the year, and are in the process of further strengthening our management team to ensure we have the capacity to source and manage the growth we are looking for.

Whilst the merger of the businesses occupied much time during the year, we have managed to grow the franchise numbers from 249 to 259 and have purchased shares in 4 further pharmacies – including one post 31 March. We have also exited our interests in Porirua Pharmacy Limited and Albany Unichem.

Although we had a good financial result and have cash in the bank, we have decided not to pay a dividend. There are two fundamental reasons. The first is that a significant portion of the Company’s \$10 million in cash reserves came from capital raising pre-merger. Having raised this capital, it does not make sense now to redistribute it when we believe we can put it to good use. And that’s the second reason: we will need this capital to achieve our expansion plans. This decision should not be interpreted as saying we will never pay a dividend in the future. It is a decision based on the current position of our business.

Now to the future, we see our growth being dependent on three key issues: government health care funding, retail spend and numbers of franchise and investment stores. Obviously this is for our current business model which is completely pharmacy based.

Government health spending in New Zealand is under immense pressure, as it is in every country around the globe. As the population ages demand grows. As new therapeutics and life-saving technologies are developed Government comes under increased pressure to fund them. And, at the same time, our Government is committed to reducing expenditure and lowering taxes. Healthcare funding, which includes pharmacy funding, is now at a cross roads. The current government is considering new contracting options to manage its expenditure and deliver, better, sooner, more convenient primary health care.





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It is widely recognised that pharmacy can contribute a lot more to primary care than simply providing a funded dispensary service, so we will look for opportunities to provide a broader range of primary care services supplied through our network of pharmacies. We will also look to find ways to off-set rising costs and develop incentives to provide a greater contribution to primary care, irrespective of where the funding comes from. We believe that the establishment of integrated Electronic Health Records will be an important step towards realising the potential of pharmacy. For pharmacists like us who are able to participate in large-scale programmes, it will improve the efficiency of our service delivery and, equally importantly, provide us with opportunities to better serve our customers. So it is part of our current strategy to be involved in appropriate parts of the electronic health records system.

The size of our operation – we now represent around 28 percent of the total retail pharmacy numbers – means that we are unquestionably the leader in our sector, with broad geographic representation, exposure to all aspects of retail pharmacy and considerable purchasing power. We also have the experience, credibility and physical presence that, we believe, will allow us to make a significant and considered contribution to the changing pharmacy environment.

Whilst part of our income is dependent on government funding, the retail spend in pharmacy is where the greatest proportion of our head office investment is focused – on improving the retailing results in our pharmacy franchisees and partner stores.

No one seems to have told the New Zealand public that the recession is over. This year has been a difficult time for retail pharmacies: However, industry data shows that, as a group, Pharmacybrands is more than holding its own. While the last couple of months, in particular, have been tough, we have still out-performed the market. Through June 2010, on a MAT level, in retail sales we are growing by 1.3 percent, while the rest of pharmacy declined by 5.2 percent in retail.

This growth came primarily in the health categories, where our focus on weight management, core health areas such as analgesics and natural health products paid off. Off-setting this, sales of beauty products declined: as the impact of the recession become evident, with consumer spending showing the first signs of slowing in November 2009 and erratic sales continuing well into 2010.





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Part of our focus is to develop retail models that will serve us into the future. Developing these models includes international benchmarking, analysing local market data, developing new product categories and making better use of an important resource; our experienced, successful New Zealand retail pharmacists.

One highly successful retail initiative has been the Life Pharmacy Living Card, a loyalty programme for Life Pharmacy, which continues to go from strength to strength; we now have over 300,000 members, an increase of 25 percent on last year. Living card members continue to be our most loyal customers: average transactions are 2.2 times greater than non-living card members. Last year the Living Card accounted for 35 percent of our transactions and 55 percent of total retail sales, 4 points up on last year. Amcal and Unichem pharmacies continue to successfully use Fly Buys as their loyalty scheme.

Prescription volume is roughly in line with last year.

Our efforts in these two areas – dispensing services and retail sales – will enable us both to capitalise on our strong position and build a platform for future growth.

We expect to achieve that growth in both our franchise business, which underpins the national coverage and support we have from owner operators, and in our holdings in partnership stores, which represent our principal asset base and enduring strength. Both areas are critical to our success; both will receive the focus they need.

Our goal for pharmacy ownership is to achieve at least 51 percent owner-operators in each partnership store, as this model best balances the skills, professional service and dedication of the pharmacist-owner with the services provided by the franchisor. In some of our stores we have multiple pharmacists involved in the 51 percent stake holding. Over the next year the company will be working with these existing business partners to move towards a 51 percent owner-operator model.

The company is determined to use our strong balance sheet, our market knowledge and intellectual property to grow our penetration in the pharmacy sector, and also to look for opportunities in the wider primary health care market.





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Our operational focus for the 2010-2011 year is to capitalise on our existing advantages and to pursue opportunities to extend those:

- We will add partnership stores to our portfolio to increase our equity interest in the overall pharmacy sector.
- We will continue to carefully manage the cost structure for existing businesses to re-balance rentals and optimise labour.
- We will leverage our size and buying power both to facilitate franchisee growth and to enhance profitability. Having a critical mass enables us to pursue own brand strategies. Our plans in this regard are progressing well.
- We will enhance our retail capability to ensure we can compete effectively against all our competitors. This will require us to undertake initiatives in four areas: to make additional investment in back office systems; to achieve further economies in our merchandising and marketing approach under existing promotional programmes; to develop a web strategy with an integrated e-commerce offering; and to ensure we apply the best retail metrics to continually refine our ranges.

Finally I want to say thank you to four groups of people. Merging two companies is never easy; credit and thanks must go to Alan and his management team for achieving this in a dignified, timely and fiscally successful manner. They undertook an enormous amount of work, first to make the merger happen, then to bring the two organisations together and, following that, to ensure that we achieved the anticipated synergy benefits.

I would also like to thank everyone in the corporate office. Mergers can be difficult; they can be stressful. This one was executed quickly, smoothly and successfully and the atmosphere within head office is calm, friendly and efficient. This is a very positive reflection on all those working there.

I also want to thank the pharmacists and all the people who work for them. While this is a corporate business with investments in a number of pharmacies and a franchise operation that operates in the pharmacy sector, its heart and soul is in the more than 250 pharmacies in malls, main streets and communities throughout New Zealand. The people who own and work in them represent our brands and it is their professionalism and commitment to serving their customers that is, and will remain, our primary strength.

Finally I would also like to thank the Pharmacybrands Board for the support and enthusiasm shown to ensure this company proves to be successful for all stakeholders.



Care Chemist

