Commentary

How McKesson's Potential Disposition of Rexall Could Have a Notable Impact On Canada's Retail Landscape

Morningstar DBRS
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Key Highlights
- While there is no certainty about whether a transaction will ultimately go ahead and no clarity on what the exact terms of a disposition would be or who might be the acquirer, we believe the disposition could have a notable impact on Canada's retail landscape.
- Given its market position and brand strength, Rexall could be a strategic acquisition opportunity not often available to a large pool of buyers including food and nonfood-retailers.

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According to unconfirmed media reports, Rexall Pharmacy Group ULC's (Rexall) parent, McKesson Corporation (McKesson), is exploring a potential divestiture of the retail pharmacy component of the business.[1] McKesson acquired Rexall, one of Canada's largest pharmacy chains with approximately 400 drug stores across the country, in 2016 for approximately $3 billion.[2] McKesson also acquired Well.ca, a leading e-commerce platform offering health, wellness, and beauty products in 2017.[3] While there is no certainty about whether a transaction will ultimately go ahead and no clarity on what the exact terms of a disposition would be or who might be the acquirer, we believe the disposition could have a notable impact on Canada's retail landscape.

Challenging Run for McKesson and Rexall

Although the potential disposition seems to be part of a global refocusing following the sale of McKesson's pharmacy businesses in France, Italy, Ireland, Portugal, Belgium, and the U.K. in 2021,[4] the decision may also be driven by Rexall having faced some difficulties over the years. Soon after McKesson acquired Rexall in 2016, Rexall was faced with generic drug price reforms that negatively affected the industry's profitability. This, in combination with stiff competition, resulted in Rexall closing nearly 10% of its locations in 2018.[5] Nevertheless, given its market position and brand strength, Rexall could be a strategic acquisition opportunity not often available to a large pool of buyers. This is not excluding private equity, which could certainly be interested as evidenced by Persistence Capital Partner's recently announced acquisition of Neighbourly Pharmacy.[6]

Who Are the Potential Buyers?

The possible pool of strategic buyers could include a number of different types of retailers. Non-food retailers, such as fuel and convenience or general merchandise retailers, could be potential buyers looking to diversify their relatively more discretionary business into the comparatively more defensive pharmacy and drugstore segment. In particular, pharmacies' increased focus on front store offerings, including beauty, wellness, and food as well as other general and convenience merchandise, could make Rexall a target, even for retailers that do not have any pharmacy experience. Another set of potential buyers—albeit with some exceptions, arguably the most likely—are Canada's major domestic grocers. Canadian leading domestic grocers already operate complementary pharmacy businesses and

1 Rexall pharmacy chain put up for sale as American owner rethinks Canadian footprint, sources say. Globe and Mail. January 14, 2024.
2 DBRS Confirms McKesson after Agreement to Acquire Rexall Health. Morningstar DBRS. March 2, 2016.
3 McKesson Canada announces the acquisition of Well.ca. McKesson Canada. December 4, 2017.
4 PHOENIX group completes acquisition of McKesson companies in Ireland. United Drug. November 2, 2022.
5 Rexall to shutter some stores as pharmacy market faces pressure. Globe and Mail. April 27, 2018.
6 Persistence Capital Partners signs deal to take Neighbourly Pharmacy private. Globe and Mail. January 15, 2024.

are well positioned to focus and capitalize on the drugstore sector's aforementioned increased focus on front store food offerings. While the pool of potential buyers could also include foreign retailers looking to take this opportunity to expand into the Canadian marketplace, including some of the U.S. pharmacy chain operators, multiple retreats of U.S. retailers from Canada over the years could affect their investment decision.

What are the Potential Credit Risk Profile Implications for an Acquirer?

Depending on whom the buyer is and what the ultimate details of a potential transaction may be, there are likely to be notable nuances regarding the impact of such a deal on the acquirer's overall credit risk profile. This is largely because there may be considerable differences in the characteristics of potential buyers' existing businesses, including their relative size, as well as variances in their financial positions, including the relative headroom within their current rating category.

That said, subject to a successful integration, an acquirer's Business Risk Assessment (BRA)[7] could see at least some longer-term benefits. These benefits could include an enhanced Nature of Product Offering BRA factor, especially for retailers that currently have a higher reliance on more discretionary product offerings. Conversely, this benefit would be considerably less meaningful for retailers with already relatively more staple businesses like a grocer. Similarly, these benefits could also extend to varying degrees across other BRA factors, including Market Position, Size and Scale, Geographic Diversification, and Brand Strength. Relative size aside, acquisition by an already nationally diversified entity would, for example, have less of a positive effect on the buyer's Geographic Diversification BRA factor than it would on that of an acquirer with a more concentrated footprint. Furthermore, although subject to considerable integration and execution risk, especially in the context of the recent increase in the cost of capital, an acquirer could see notable Operating Efficiency BRA factor gains should meaningful synergies be realized through cross sourcing, fulfillment, and selling, such as the integration of Rexall's Well.ca e-commerce platform into an acquirer's existing e-commerce platform. At the same time, while highly dependent on how the purchase amount, funding mix, consolidated earnings potential (including synergy expectations), and any associated deleveraging plans inform our forward-looking financial profile expectations, an acquisition could bring with it at least near-term strains on the acquirer's Financial Risk Assessment (FRA).[14]

The combined effects on the acquirer's BRA and FRA would inform our assessment of a potential acquisition's effects on the buyer's overall credit risk profile. That said, this assessment could have notable differences depending on whom the acquirer is and how comfortably the buyer is positioned within the context of its current rating category. Furthermore, this view could be different over the near to medium to longer term.

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7 As outlined in our Global Methodology for Rating Companies in the Merchandising Industry.

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