

Pharmaceutical Retail Market in 2006

The Defining Year

by Raiffeisen Investment Romania

Overview of the market

Brief presentation of the main players on the Romanian pharmaceutical market

Current legal and economic framework

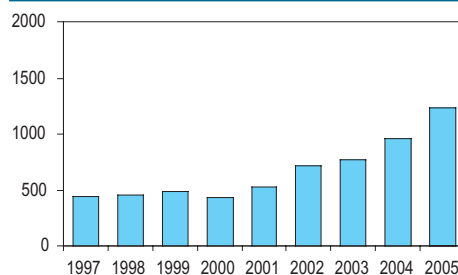
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Overview of the market

The Romanian pharmaceutical market reached EUR 1.23 bn in the twelve months ending in September 2005, according to the market research company Cegedim. This figure is only 2.7% higher than the previous twelve months average ending in June 2005, indicating that the market throughout most of 2005 has stagnated relative to 2004. For the third quarter of 2005 only, the market amounted to EUR 310 mn, a figure virtually similar to the one corresponding to the previous quarter, but also to the first quarter of 2005, during which sales stood at EUR 311 mn. The pharmacies accounted for approximately three quarters of the overall pharmaceutical sales whilst the hospitals accounted for the difference. The average drugs sales in 2005 through the two market segments exhibited contrasting variations as the increase in the retail segment – by 4.2% was partly offset by the 1.6% decrease in the hospital segment. On the retail side, the sales of OTC drugs represented 20% of the overall sales whereas the sales of Rx drugs accounted for the remaining 80%. Over the above mentioned period, the OTC drugs, however, have displayed a higher growth rate (4.8%) than the Rx drugs, (4.1%).

Pharmaceutical market
(wholesale price, EUR mn)



Source: Cegedim

These data provide additional support to the view that in 2005 the pharmaceutical market has experienced a more stable, though significantly reduced, growth rate, following the significant increase experienced in 2004, when the market expanded by approximately 30% to EUR 960 mn. However, there are still significant uncertainties regarding the short term trend evolution of the market, mostly concerning the payment of arrears owed by the National Health Insurance House (NHIH) to the pharmacies for the state-reimbursed drugs. These arrears were accumulated mainly during the second half of 2004 and the first quarter of 2005. The sales of state-reimbursed

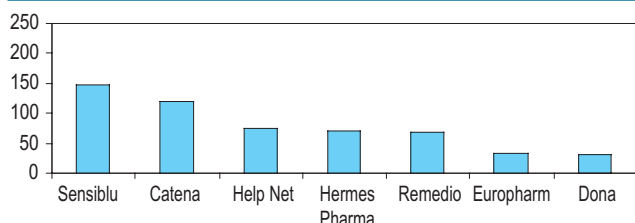
drugs in that quarter approximated EUR 147 mn, relative to the EUR 56 mn of the similar period of 2004, which represented a 160% increase. As a consequence of this explosive increase in the sales of the state reimbursed drugs, the amounts owed by the NHIH to the pharmacies and wholesalers followed a similar path and the latter threatened to stop the provision of medicines to hospitals unless they received payment from the NHIH. As a response to this situation, the Ministry of Health offered to pay EUR 43 mn to the pharmaceutical suppliers, out of a total EUR 280 mn debt outstanding, but only to those pharmaceutical wholesalers which accepted a 6.2% reduction in their unpaid arrears. Additionally, the Ministry of Health modified during 2005 the pricing system of Rx drugs in order to lower the margins of wholesalers and pharmacies.

According to a study carried out by the Economist Intelligence Unit (EIU) the estimated expenditure per capita on healthcare in Romania approximates EUR 160, relative to the EU's average of EUR 1,000. The study also highlights that, although 96% of Romanian citizens are

registered with a local doctor, outpatient care is poor, with a very low doctor/patient ratio of 1.9 per 1,000 inhabitants. Furthermore, the drug consumption per capita, at an estimated EUR 25 in 2005, is among the lowest in Europe (less than half that of Hungary, the Czech Republic and Poland, and 14% of that in the EU), but it is expected to reach EUR 85 by 2007, as stated in the EIU report. Concerning the evolution of the Romanian pharmaceutical market, the report estimates that the market will reach EUR 1.46 bn in 2007. The EIU report stresses that the market share of imported drugs has grown rapidly from 45% in 1996 to 75% in 2004. Most of the imports are from the EU countries, with France and Germany, as leading suppliers, accounting for approximately 30% of imports. However, imports account for only about 20% of the market by volume, as the domestic producers largely concentrate on the production of low-value generic drugs and imports are concentrated on more sophisticated, patent-protected, drugs.

Brief presentation of the main players on the Romanian pharmaceutical market

Leading pharmacy chains by number of pharmacies



Source: Corporate reports

Sensiblu

Sensiblu, founded in 1997, has, over the years, become the largest pharmaceutical retail chain, both by turnover and by number of pharmacies under operation. The company currently operates 147 pharmacies throughout Romania and, together with the wholesaler Mediplus, is part of the largest Romanian pharmaceutical group, A&D Pharma. **Mediplus**, formerly known as Plurifarm, is the leading pharmaceutical wholesaler in Romania and it operates a network of 12 warehouses with a total storage capacity of 10,000 sqm. Sensiblu was the first pharmacy chain in Romania to introduce a loyalty card program, which has already succeeded to attract more than 800,000 registered customers. In order to offset the negative effects of the financial volatility affecting the Romanian health sector, the company has announced its intention to focus in 2006 on expanding into higher value-added areas such as cosmetics, through strategic partnerships such L'Occitane brand, which Sensiblu has introduced in Romania in 2005. Other strategic initiatives for Sensiblu in 2006 will be the preparations for the introduction of private health insurance programs and future investments intended to boost operational cost efficiency. In terms of growth, the company has been rumoured to be the front bidder for the acquisition of the Europharm retail chain, owned by GSK, who has been thought to be considering the divestiture of the pharmacies it had acquired together with the Europharm pharmaceutical plant. There have also been rumours of a takeover of A&D Pharma by one of the large European pharmaceutical companies, but company officials have stated that no satisfactory offer has been received and that as a medium term plan, the company's shareholders were pondering the possibility of listing the company on the stock exchange.

Catena

Catena, originally known as Argesfarm, a state-owned company until 1999, it was acquired by Fildas through a privatisation. Fildas is the third largest pharmaceutical wholesaler in Romania, with a nationwide distribution network of 16 warehouses. Catena currently operates 32 pharmacies in Bucharest and other 86 pharmacies throughout Romania, which constitute the second largest pharmaceutical retail chain after Sensiblu.

Help Net

Help Net was established in 1998 by the pharmaceutical wholesaler Farmexim and its first pharmacy was opened in Timisoara. In 2002 the retail/pharmacy business was spun off from the wholesaler and registered as an independent company. Also in 2002 the Help Net brand was adopted and the expansion of the pharmacy network commenced. In 2004 the number of pharmacies reached 52 whilst as of December 2005 there were 75 pharmacies operating under the Help Net brand. The company ranks among the five largest pharmacy chains in Romania by number of pharmacies. Help Net plans to operate 200 outlets by the end of 2006 through either a partnership with a foreign investment fund (organically) or acquisition of rival companies.

Hermes Pharma

Hermes Pharma is the pharmaceutical retail arm of the Relad group, which also includes Relad Pharma, the largest pharmaceutical wholesaler in the distribution market to hospitals and the third largest wholesaler in the distribution market to retail. According to media sources the Relad group operates approximately 70 pharmacies but less than half of them are operated by Hermes Pharma. Hermes Pharma was established in 2000 and it currently operates 22 pharmacies under the brand City Pharma, of which 6 are located in Bucharest. The pharmacies were initially operated under the Hermes Pharma brand but in 2004 they were re-branded as City Pharma.

Remedio Farmacii SA

Remedio Farmacii SA was established in 2004 as the pharmaceutical retailer of the Montero group, one of the leading Romanian pharmaceutical wholesalers. The company has taken over some of the pharmacies already operated by the Montero group and it commenced the expansion of the pharmacies network. Most of the pharmacies operated under the Remedio brand are half owned by Remedio Farmacii SA and the other half by the operating pharmacist. The company provides its partner pharmacies with the brand and it additionally offers logistics and IT support, as well as medicine procurement through the subsidiaries of the Montero group. The company is one of the leading pharmacy chains in Romania by number of pharmacies. In 2005 Remedio Farmacii SA took over the 10 Eurofarmacia pharmacies previously owned by the Lithuanian-based VP Market and has still to re-brand the shops as Remedio pharmacies. The Company intends to extend its pharmacy network from the 68 pharmacies which it currently operates to 200 pharmacies over the following 36 months.

Europharm

Europharm, owned by GSK, is one of the largest pharmaceutical retailers in Romania. The company operates a network of 33 pharmacies in 18 cities across the country. The retail company was acquired by GSK together with the Europharm pharmaceutical plant. The wholesale arm of Europharm has a strong presence on the hospital segment of

the distribution market and it currently operates a national distribution network of 16 warehouses. As for the retail arm, since its acquisition, GSK has not actively focused on improving Europharm's market position and it has maintained the original outlet design and the sales strategy. In 2005, the Europharm pharmacies were spun off as an independent company, a move which originated rumours concerning its possible sale by GSK.

Current legal and economic framework

In Romania, until 1989 the entire pharmaceutical sector was under the absolute control of the state. The state monopoly of the pharmaceutical retail market was eliminated in 1991 when the pharmacies were privatised and organised according to the law governing commercial entities. After the privatisation of the sector there were no restrictions concerning the ownership of the companies, and the only restrictions concerned the demographic and territorial criteria. In 1994, the regulation stipulated that the minimum distance between two pharmacies had to exceed 500 meters, which was afterwards reduced to 250 meters. In 2001, the territorial restriction was eliminated and currently the pharmacies' establishment and operation are regulated according to resolutions of the Health Ministry (RHM Nr. 626/2001 modified by the RHM Nr. 1199/2004), with the only restriction concerning the demographic criterion.

- The current legal framework governing the establishment and operation of pharmacies includes the following aspects:
- The pharmacies are organised as normal commercial entities, without restrictions concerning their ownership;
- In order to operate under a legally-compliant structure a pharmacy requires an authorisation from the Health Ministry, which is based on the approval report issued by the General Pharmaceutical Department within the Health Ministry;
- The operating authorisation can be either permanent (as determined by the RHM Nr. 1199/2004) or valid for a period of 5 years (for those authorisations issued prior to the RHM Nr. 1199/2004);
- The establishment of pharmacies in urban areas is restricted according to a demographic criterion, which stipulates that a new pharmacy may be established for a minimum number of inhabitants, number which is regulated by another resolution of the Health Ministry. The minimum number of inhabitants required for the establishment of a pharmacy has been gradually decreased over the years from 7.000 inhabitants per pharmacy in 1991 to 5.000 in 1997. Under the current regulation, in place since 2004, there cannot be more than one pharmacy per 3.000 inhabitants in Bucharest, one pharmacy per 3.500 inhabitants in the cities which are county capitals and one pharmacy per 4.000 inhabitants in the rest of the towns;
- There are several exemptions from the demographic restriction, which concern areas with high demographic density, such as the train stations and the commercial malls;
- The pharmacy is run by the chief pharmacist or, in the chief pharmacist's absence, by another designated care-taking pharmacist;

- The responsibility for the pharmaceutical retail activities belongs to the pharmacist, according to the law governing the pharmacist profession;
- The pharmacists can be hired by the pharmacies either as employees or as third-party professionals, contingent on the former being granted the free practice authorisation issued by the Health Ministry.

Under the current legal framework a process of ownership concentration of the pharmacies has gained momentum over the last couple of years and a growing number of pharmacy chains have increased their market share through continuous investments in marketing and network expansion. According to the association representing the pharmacy chains, there are currently 150 pharmacy chains, of four or more pharmacies, operating in Romania. The total number of pharmacies which can be considered as part of a pharmacy chain approximates 1.500, corresponding to an aggregated investment in excess of EUR 150 mn. These pharmacy retail chains employ almost 15.000 people, of which 3.500 are pharmacists. Most of the pharmacy chains have been initially created as divisions of the main pharmaceutical wholesalers, and afterwards spun off as independent companies. The leading pharmacy chains share ownership with some of the largest pharmaceutical wholesalers such as **Sensiblu** and **Mediplus**, **Help Net** and **Farmexim**, **Catena** and **Fildas Trading**, **Remedio** and **Montero**, **City Pharma** and **Relad**, **Dona** and **Farmexpert**.

According to a study by the Pharmacists College, there are currently 4.500 community pharmacies operating in Romania, whilst the number of pharmacists registered with the Pharmacists College does not exceed 8.500. Of the latter, approx. 1.000 are employed in other fields (pharmaceutical companies, pharmaceutical wholesalers, hospitals, R&D entities). According to the existing regulation, the minimum number of pharmacists required for the normal operation of a pharmacy, with an opening hours programme of eight hours, is of two pharmacists. Approximately 30% of the community pharmacies operate under an extended opening hours programme, requiring 3 pharmacists, whilst other 10% of the pharmacies have a 24 hours opening hours programme, requiring 4 pharmacists. Thus, if there were a uniform compliance with the existing regulations there would be a deficit of pharmacists in excess of 2.000. An immediate consequence of this situation is the fact that the main problem affecting the pharmaceutical retail sector is the lack of specialised personnel, which leads to an imbalance between the supply and demand for specialists, with the consequential increase in wages and in the number of pharmacies which do not comply with the corresponding regulations. This situation has most severely affected the independent pharmacies, which have been forced to compete with the pharmacy chains, which are generally able to offer the employees better terms and conditions. The deficit of pharmacists has also induced the concentration of pharmacists within the urban areas, mostly in the large cities, with the subsequent detrimental effect of the closing of pharmacies in the rural areas. Given the current annual graduation rate of 550 pharmacists, the Romanian Association of Pharmacy Chains estimates that, under a *ceteris paribus* framework, four more years will have to lapse before the pharmaceutical labour market reaches equilibrium. Pharmacy chains, such as **Sensiblu**, in order both to find a remedy to this situation and to ensure themselves the required specialised staff, have initiated scholarship programmes for Pharmacy students.

According to a study by Primula Officinalis, a pharmaceutical specialised consulting firm, there have been consistent infringements of the regulations regarding the demographic criterion with the most severe cases occurring in Bucharest. Thus, in spite of the fact that in 2003, according to the regulation which stipulated that there could be only one pharmacy per 5.000 inhabitants, thus limiting the total number to 412 pharmacies operating in Bucharest, the actual number of pharmacies in the city approached 650. The same situation prevailed at the end of 2004, when, in spite of the fact that, according to the new regulation which had reduced the minimum number of inhabitants per pharmacy to 3.000, the number of pharmacies in Bucharest could not exceed 686, the actual number was close to 800. Furthermore, in January 2005, 40 additional pharmacy licenses were issued, which increased the number of pharmacies operating in Bucharest to 833, a 21% more than what would result from the strict application of the existing regulations. This is a striking finding as the Ministry of Health holds the authority and responsibility for issuing the pharmacy licenses.

The opposite situation has occurred in the rural and smaller urban areas where there has been a deficit of pharmacies. There are towns of 30.000 of 40.000 inhabitants with only one pharmacy or rural areas with thousands of inhabitants who do not have access to a pharmacy within reasonable distance.

The new pharmacy law: threats and opportunities

The pharmaceutical retail sector has evolved over the last 15 years in a rather simplified legal framework. Except for the restrictions concerning the demographic criterion and the requirements governing the pharmaceutical profession, the companies have enjoyed a rather stable and liberal legal environment. However, there have been constant voices, mostly from the side of the independent pharmacies, demanding the introduction of a law with the objective of more strictly regulating and controlling the sector. Faced with the increase in size and influence of the pharmacy chains, the independent pharmacists have constantly demanded that the size of the former be curbed down and that segregation between wholesalers and retailers be introduced. In spite of these demands, the previous Health Minister, Mr. Cintează, announced that the Ministry would draft a Pharmacy Law which would liberalise the pharmaceutical retail market. However, Mr. Cintează was removed from the Ministry in the summer of 2005 and replaced by Mr. Nicolaescu.

One of the first measures taken by Mr. Nicolaescu upon his appointment as Minister of Health was to put on hold, until the end of 2005, all the authorisation requests for the opening of new pharmacies.

Furthermore, one of the main initiatives of the current Health Minister was to propose a Pharmacy Law, aimed at providing the appropriate regulatory framework for a highly important sector which has evolved over the past 15 years in the absence of a structured regulation. The draft law stipulates that the Pharmacy is a specialised health entity, of public interest, which the former is set to support and protect. The two most important underlying principles of this law are the principle of professional capacity and the principle of universal access to the pharmaceutical services. The first principle states that the establishment and operation of the pharmacy relies on the qualification and professional experience of the person requesting the operating license. The second principle states that the establishment of a pharmacy must have the primordial objective of providing

pharmaceutical services to the part of the population deprived of such services.

Some of the most important resolutions included in the draft of the Pharmacy Law proposed by the Health Ministry are the following:

- In a pharmaceutical retail company, one or more pharmacists must own at least 51% of the subscribed share capital and the position of administrator or the majority of the votes in the board of administration. Individual pharmacists may own the majority of the subscribed share capital of a pharmaceutical retail company. A pharmaceutical retail company can only establish one pharmacy;
- The rental, donation or sale of a pharmacy have to be made in accordance with the present law and only to a pharmaceutical company compliant with the above mentioned regulation;
- Pharmaceutical retail companies are forbidden to undertake medical activities, production, import or distribution of medicines;
- In Bucharest there can only be a pharmacy per every 2.500 inhabitants within each district, whilst for the cities which are county capitals there can be a pharmacy per every 3.500 inhabitants and for the rest of the cities there can be a pharmacy per every 4.000 inhabitants;
- As exception to the above mentioned demographic restriction, it is allowed to establish new pharmacies in commercial malls, train stations, airports and tourist resorts if there are no other pharmacies operating in the same location or within a 250 meters range;
- The self-service practice for medicines retail is forbidden in all pharmacies and drugstores;
- The pharmacy's sign board must contain only the word "pharmacy", a differentiating name and the equal sided, right angled, green cross on a white background;
- The colours which can be used for the company's sign name and are green and white;
- The signing of any contracts or agreements between the pharmacy and the doctors, wholesalers or medicine producers which can lead to exclusivity or preference in the acquisition and sale of medicines with beneficial consequences for any of the signing parties is forbidden;
- Pharmaceutical producers, importing or distribution companies are barred from the ownership of pharmaceutical retail companies;
- The drugstore is defined as the entity whose purpose is the provision of the general public with over the counter medicines, hygiene-cosmetics products, nutritive supplements, anodyne plants and medical devices;
- The demographic and geographic criteria shall be deemed inapplicable after the conclusion of seven years following the approval of the law;
- The pharmacies included in pharmacy chains cannot exceed 10% of the total number of independent pharmacies operating within each county, including Bucharest;
- For the purpose of this law, four or more pharmacies belonging to the same owners constitute a pharmacy chain;

- The pharmacies are forbidden to advertise by any means the pharmaceutical services they provide;

The Romanian Association of Pharmacy Chains (RAPC), representing the interests of the pharmacy chains, has hired legal advisers in order to overturn the law on legal grounds as they consider the draft law as detrimental to their business and unconstitutional. The legal advisers hired by the RAPC consider that the draft Pharmacy Law infringes on the inviolability of private property and on the legal framework protecting private investments, by restricting the sale, donation or rental of the pharmacies only on a pharmacy by pharmacy case and only to companies which are compliant with the regulations included in the proposed draft law. They also judge that the proposed Pharmacy Law breaches the Constitution of Romania given that the sudden introduction of restrictions regarding the ownership of the pharmacies, the maximum number of pharmacies which a single person or company may own, or the restriction regarding the divestiture of a pharmacy may be constitutionally considered as: a sudden and unlawful limitation of the application of the rights of all pharmacy owners who do not possess the pharmacist qualification; an unjustified breach of the right to equal treatment, without privileges nor discriminations; a limitation of the right of free association under the form of commercial ventures; a breach of the protection of the freedom of commerce, of the fair competition and free initiative.

Additionally, RAPC's lawyers judge that the draft Pharmacy Law negatively affects the legal situation of the 16 pharmaceutical retail companies formerly owned by the state and which have been privatized through their listing on the Rasdaq Stock Exchange and it thus breaches the rules of the capital markets. The former also deem that the proposed law contravenes the free competition rules and the current EU principles regarding the Union's internal market for services. These principles dictate that both the structure of the market for pharmaceutical services and the contractual agreements under which the market is organized must comply with the general regulation concerning the abuse of dominant position, the concentration of economic power and the prohibition of anti-competitive practices.

The RAPC's counsellors also stress what in their view represents the lack of fundament behind the reasoning for the change in the regulation of pharmacies. According to the Ministry of Health, the changes are aimed at „*the elimination of monopoly in the pharmaceutical sector through the elimination of pharmacy chains or through the limitation of the number of those pharmacies*”. Based on the estimates of the RAPC, the number of pharmacies operated by pharmacy chains does not exceed 30% of the existing pharmacies. Furthermore, the counsellors consider, the responsibility of the elimination of potential anti-competitive practices lies with the Competition Council, in compliance with the existing legal framework. The RAPC also emphasizes the fact that the pharmacy chains are unable to affect the price of medicines, as the price of RX drugs is determined by the Ministry of Health.

The legal counsellors of RAPC also argue that the regulation included in the draft Pharmacy Law, which limits the number of pharmacies organized as pharmacy chains and the interdiction of contracts between pharmacies and pharmaceutical wholesalers which may lead to exclusivity or preference arrangements, contravene the Competition Law. In their view, the same conclusion applies to the prohibition of using the current brand names, thus restricting, blocking and distorting competition.

The counsellors deem that the draft Pharmacy Law fails to identify an objective reason to support the changes proposed to the current regulatory framework, in the absence of a public interest in need of protection. In their view, the new measures do not benefit the consumers and the reference to similarly restrictive regulations in place in other European countries is inconclusive and it cannot possibly support unconstitutional measures. The latter measures can neither be supported by the “*special features of pharmacies*”. The legal advisers conclude that the draft Pharmacy Law protects solely the interests of independent pharmacists and, as additional evidence to support this conclusion, they highlight the numerous similarities the proposed law bears with the draft proposed by the Pharmacists' College in 2003. The RAPC threatens to file lawsuits in the Constitutional Court and in the European Court of Human Rights if the law is adopted in the form proposed by the Health Ministry.

The Pharmacists' College has publicly endorsed the current draft of the Pharmacy Law, which embodies the principles which the College has advocated for since 2002. The College has discussed these demands with all the Health Ministers, with the Ministry of European Integration and with the Competition Council.

The Association of Pharmacy Owners, representing the interests of independent pharmacists, has publicly demanded the immediate approval in Parliament of the draft Pharmacy Law in its current form. In their view, it is imperative that the pharmacist's ownership of the pharmacy and the segregation of pharmaceutical import, distribution and commercialisation are introduced, in order to protect the patients' health and life. The independent pharmacists stress that they will only accept the professional pharmacists' full ownership of the pharmacy as any other degree of ownership would allow individuals without relevant professional qualification to interfere in the pharmaceutical act. As support to the draft law, the independent pharmacists argue that the current structure of the Romanian pharmaceutical market, under which the pharmaceutical importing and manufacturing companies own wholesalers and pharmacies, contravenes the EU practice.

The president of the Competition Council, Mihai Berinde, has labelled the draft Pharmacy Law as anti-competitive and un-European and has added that the Competition Council has been a constant militant for the elimination of any restrictions based on the demographic or geographic criteria.

The United States Embassy stated its concern that the new Pharmacy Law would artificially limit the competition in the pharmacy field. It also expressed its belief that the restrictive measures outlined in the proposed legislation would result in arbitrary constraints on pharmacy chains and that these measures would not bring improved care or access to Romanian consumers. The US Embassy concluded that the pharmacy chains have introduced an improved level of customer service to the Romanian population, driving competition rather than restricting it and that the Pharmacy Law, in its current form, represents a step backwards.

The draft of the Pharmacy Law has also been publicly criticized by the head of the European Commission's Delegation in Romania, Jonathan Scheele, who stated that the proposed law has not been drafted in accordance with the European model, as the only EU regulation regarding the pharmacies is the one stipulating the sale of medicines only by authorized pharmacists. Furthermore, Mr. Scheele deemed that the application of the measures stipulated in the draft Pharmacy Law restricting the sale of pharmacies would have a negative impact on the value of private property and subsequently, as any law of similar consequences, it could be

successfully challenged in any state of the EU. Additionally, the head of the Enlargement Division of the European Commission, Mr. Barbaroso has warned the Romanian Health Ministry that, although similar restrictions are enforced in some of the Union's member states, this does not signify that they are in accordance with the European treaties. Furthermore, the EU official has stated that the European Commission has already requested three member states to eliminate similar restrictions and that the tendency within the EU is to relax the regulation of the pharmacy market.

The draft Pharmacy Law proposed by the Health Ministry has therefore proven to be highly controversial and, given the large financial interests influenced by the changes in the regulatory environment, all the parties affected by the law have attempted to attract the maximum public and political support for their cause. Faced with strong opposition from the RAPC, the Competition Council, the EU Commission et al., the Health Ministry has withdrawn the draft law from the bundle of draft laws for whose approval the Government was expected to assume responsibility in front of the Parliament. The Health Ministry has declared that the draft law will be sent to the Parliament after an agreement with the EU Commission was reached. However, it remains unclear whether the Health Ministry will manage to gather the votes required to pass the law, in its proposed form. Even within the MPs of the ruling Liberal Party there have been voices labelling the draft law as restrictive and un-liberal and thus unacceptable.

Sector outlook

The medium term evolution of the Romanian pharmaceutical market will most likely benefit from the increased purchasing power of the population, the enhanced healthcare awareness and the state's improved ability to finance the needs of an ageing population. The sales of OTC drugs, prescription medicines and hospital products are expected to rise significantly over the next five years. Assuming that the commitment of the current Health Minister is fulfilled and thus healthcare expenditure is given greater priority within the state budget, and that foreign manufacturers will continue to increase their involvement in the operation of production facilities in Romania, the production of pharmaceutical products is expected to double from its 2004 level by 2009.

However, the uncertain conclusion of the debate regarding the regulatory framework of the pharmaceutical market will affect the way the market develops over the next five years. If the pharmacy law is approved in its current form, it will halt the investments in the pharmaceutical retail activities, as the current pharmacy chains will have to stop their expansion and the independent pharmacists will not have the strength to expand their customer base nor the legal possibility to acquire more than three other pharmacies. The demographic criterion concerning the issuance of pharmacy licences will strictly limit the number of pharmacies operating on the market and the geographic criterion will further hinder the competition among the latter. The degree of competition on

the market will also be negatively affected by the prohibition for the pharmacies to differentiate themselves through branding and marketing activities. Additionally, the restrictions to be imposed on the sale of pharmacies, which are to be made solely on an individual basis and only to professional pharmacists, will block the entry of foreign investors on the pharmaceutical retail market and negatively affect the valuation of the pharmacy chains. The segregation of ownership between pharmaceutical wholesale and retail activities stipulated in the draft Pharmacy Law, if approved by Parliament, will affect the current structure of the market, as the largest pharmacy chains are either directly owned by or have common ownership with the leading pharmaceutical wholesalers. The imposed segregation between pharmaceutical wholesale and retail companies will present a threat to the latter as they will no longer be able to rely on the trade financing they have received from the former. The wholesalers will also have to develop their business without relying on the sales to the previously captive pharmacies. Given the restrictions on the sale of pharmacies there is a greater likelihood that the foreign investors will focus exclusively on their entry on the pharmaceutical wholesale market, which, given its current degree of fragmentation, will experience a consolidation process with a series of existing wholesalers either forced out of business or acquired by the larger players.

If the draft Pharmacy Law is ultimately abandoned and thus the legal framework regulating the pharmaceutical market remains unchanged, both the wholesale and retail segments of the latter will experience an accelerated process of consolidation over the following five years. It is to be expected that foreign companies will enter the Romanian market, attracted by its higher growth rate relative to the EU average, the significant differential in medicine spending between Romania and other European countries and its high degree of fragmentation. On the pharmaceutical retail market, with the number of pharmacy licenses capped by the demographic criterion the larger pharmacy chains will continue to expand their network through acquisitions of individual pharmacies and smaller pharmacy chains. Independent pharmacies will face mounting pressure to increase their sales and to boost their efficiency as the pharmacy chains will continue to invest in branding and marketing activities whilst transferring some of their efficiency gains onto their customers through discounts granted via loyalty schemes. Furthermore, the larger pharmacy chains will proceed with the strategy of increasing the attractiveness of the pharmacies by adding cosmetics and baby care products to the product range, and by providing additional services such optical services. Hence, independent pharmacies will face increasing difficulties to compete with more visible and efficient pharmacy chains and will subsequently continue to lose market share, both in terms of number of pharmacies and in terms of turnover. It is to be expected that the most successful independent pharmacists will be the ones which will benefit from privileged locations in city centres or in highly populated areas.

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