

Purchasing An Established Pharmacy/Junior Partnership

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Learning Objectives

- Estimate the value of a community pharmacy
- Determine the net profit of a pharmacy
- Determine the selling price to achieve a ROI of 15%

Learning Objectives

- Calculate a pharmacy selling price using various approaches such as the Bank of America, net income, net profit, asset and others
- Establish guidelines for the sale of a community pharmacy practice to a junior partner over a six-year period

Advantages of Purchasing an Established Pharmacy

- Fewer risks (fewer unknowns)
- Obtain shopping habits of patrons
- No profit lag time
- May obtain accounts receivable
- Goodwill established

Disadvantages of Purchasing an Established Pharmacy

- Excess and/or undesirable inventory
- Used fixtures and equipment
- Inherit undesirable personnel/policies
- Goodwill may be overpriced or non-existent

Basic Goals:

To enable the pharmacy manager/owner or potential owner to:

- Determine an equitable selling/purchase price for an established community pharmacy
- Design the framework and details for a transfer over several years

Determining an Equitable Selling / Purchase Price

Important for:

- Pharmacy chains are making offers to independents
- Independent pharmacy owners

Most Owners Are Managers Not Buyers / Sellers

- Once in a lifetime experience
- Set unrealistically high sale value (based on emotion)
- Sell at wrong time (business poor)

Valuation Not an Exact Science; Based On:

- Relevant facts
- Common sense
- Informed judgment
- In final analysis, it is subjective

Valuation Process

- Arrived at through negotiation
- Analysis of data enhances process
- Results in price range
- Raises negotiations from level of personal opinion to rational analysis

Elements That Influence Value

- Financial analysis
- Physical appearance and condition of pharmacy
- Cash flow
- Competition

Elements That Influence Value

- Inventory composition and condition
- Economic trends
- Managed care
- Lease terms
- Location

Elements That Influence Value

- Pharmacy image
- Repeat patronage
- Sales trends
- Terms of sale

Using Formulas

- General in nature
- No single, all-purpose formula

Adjustments to Financial Data “Normalizing”

- Owner’s salary
- “Personal” expenses
- Depreciation

Two Categories of Formulas

- Outright sale
- Stock purchase

Formulas for Outright Sale

Do Not Include:

- Cash
- Accounts receivable
- Accounts payable
- Notes payable

Formulas for Stock Purchase Include:

- Cash
- Accounts receivable
- Accounts payable
- Notes payable

Case Study

- Financial statements (figures 1 and 2)
- “Normalize”

Sales Projection

$$(.265) (\$1,320,431) = \$349,914$$

Return (Net Profit) on Investment (Purchase Price)

- $(.20) (\text{Purchase Price}) = \text{Net Profit}$
- $(.20) (X) = \$61,137$
- $X = \$305,685$

Direct Assessment (Figure 3)

Tangible Assets

• Inventory	\$143,926
• Fixtures/equipment	29,049
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Total:	\$172,975

Direct Assessment

• Earning power (10%)	\$17,297
• Salary if manager elsewhere	\$75,000
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Total:	\$92,297

Direct Assessment

• Net Profit	\$61,137
• Owner's Salary	\$63,380
Total:	\$124,517

Direct Assessment

- Extra Earning Power

\$124,517

- 92,297

\$ 32,220

Direct Assessment

- Intangible Assets = (extra earning power) (years of profit factor)
- $(\$32,220) (3) = \$96,660$

Direct Assessment

• Tangible Assets	\$172,975
• Intangible Assets	96,660
Purchase Price	\$269,635

Percentage of Sales Plus Inventory

- $(0.15)(\text{Sales}) + \text{Inventory}$
- $(0.15)(\$1,320,431) + \$143,926 = \$341,990$

Net Income Approach

- $2(\text{Net Profit} + \text{Owner's Salary}) + \text{Inventory}$
- $2(\$61,132 + \$63,380) + \$143,926 =$
 $\$392,960$

Net Profit Approach

- 6 (Net Profit)
- $6 (\$61,137) = \$366,822$

Itemization

- Inventory + Fixtures and Equipment + Goodwill
- \$143,926 + \$39,049 + \$61,117 = \$244,092

\$3-\$7 Per Prescription Filled Annually + Inventory

- $(\$5) (\# \text{ Prescriptions filled annually}) + \text{Inventory}$
- $(\$5) (34,331) + (\$143,926) = \$315,581$

\$10 Times Annual Prescriptions

- $(\$10) (34,331)$
- $(\$10) (34,331) = \$343,310$

Summary of Valuation Formulas Outright Purchase

- Sales volume: \$349,914
- Return on investment: \$305,685
- Direct assessment: \$269,635

Summary of Valuation

Formulas Outright Purchase

- Percentage of sales plus inventory: \$341,990
- Net Income approach: \$392,960
- Net Profit approach: \$366,822
- \$ Per prescription plus inventory: \$315,584
- \$ Per prescription: \$343,310

Summary of Valuation Formulas Outright Purchase

- Range: \$269,635 - \$393,960
- Average: \$335,737

Formulas for Stock Purchase

Summation of Relevant Factors

Assets	\$298,607
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Liabilities	- 78,118
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Net Worth	220,489
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Goodwill	+ 61,137
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TOTAL:	281,626
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Asset Approach

- Net Worth + 2 (Net Profit)
- $\$220,489 + 2 (\$61,137) = \$342,763$

Owner's Equity Approach

- 1.5 (Net Worth)
- $1.5 (\$220,489) = \$330,733$

Owner's Cash Flow Method

- 2-4 (Net Profit) + Current Assets – Liabilities
- 3 (\$61,137) + \$251,636 - \$78,118 = \$356,929

Owner's Cash Flow Intangible Method

- $1-2.5 \text{ (Net Profit)} + \text{Current Assets} + \text{Fixed Assets} - \text{Liabilities}$
- $1.75 (\$61,137) + \$251,636 + \$39,049 - \$78,118 = \$244,092$

Summary of Valuation Formulas Stock Purchase

- Summation of rel. factors \$281,626
- Asset \$342,763
- Owner's equity \$330,733
- Owner's cash flow \$356,929
- Owner's cash flow intangible \$244,092

Stock Purchase

- Range: \$244,092 - 356,929
- Average: \$311,228

To Summarize

- Range: \$250,000 - \$390,000
- Average: \$330,000

Establishment of a Junior Partnership (\$330,000)

- Transfer ownership over 6 years
- JP purchase 10% per year (years 2-6)
- Remaining 50% purchased end year 6
- JP purchase 10%, pays for 5%

Income to the Owner (Figure 3)

- Value of pharmacy increases 6%/year
- Ownership transfer (10%) begins at end of year 2
- Payment from JP is 5%

Income to the Owner

• Total payment from JP =	\$104,513
• Owner's share of profits =	\$370,082
• Remaining 50% of pharmacy =	\$234,055
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TOTAL:	\$708,650

Payments of Junior Partner (Figure 5)

- Paid from bonus and net profit share
- Save \$272/mo. and \$530/mo. In years 2 and 3 to avoid borrowing