Pharmacy Valuations and Their Impact on Exit Strategy Planning: How Current Industry Activities are Affecting Pharmacy Valuations

Presented by:

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This program is approved by NCPA for 0.15 CEUs (1.5 contact hours) of continuing education credit. NCPA is approved by the Accreditation Council for Pharmacy Education as a provider of continuing pharmacy education.
Educational Objectives


Presenter: Tony DeNicola, President, Buy-sellapharmacy.com

Objectives:

1. Have insight into the planning process required to conclude the successful sale of a pharmacy.
2. Understand the possible impact of current industry activities that may have an impact on the value of a pharmacy.
3. Understand the documentation required to effectively present their business in the best light.
4. Know the critical requirements of most pharmacy buyers.
5. Understand the marketing process involved in the sale of a business.
Tony De Nicola currently serves as President of Buy-Sellapharmacy.com, a Connecticut-based consulting firm that addresses the issues of evaluating, appraising, buying and selling pharmacies throughout the country. The firm provides objective advice and input to pharmacy owners and prospective owners on the issues that surround effective transition planning, development of an exit strategy for existing owners and the purchase of a pharmacy for first time buyers, as well as existing owners who wish to acquire another pharmacy. Tony and a team of six professionals, four whom are pharmacists who have owned more than fifteen stores between them, perform these functions as part of their strategic partnership with NCPA, for whom they manage the Independent Pharmacy Matching Service (IPMS). Tony participates as a speaker at many industry meetings and continuing education seminars, addressing the issues of the day for pharmacists and their suppliers in a common sense fashion.

Prior to founding Buy-sellapharmacy in 2002, Tony managed an international consulting firm, A & D Associates, which advised wholesalers and retailers around the world on various network marketing activities for 15 years. In the mid-80’s, Tony was Chief Operating Officer of Ketchum Distributors, a $300 Million dollar regional wholesaler based in Clark, New Jersey, the U.S.’s 12th largest at that time. Before that, he founded and managed the Legend Pharmacy Cooperative, the country's first retail buying group for independent retailers, which achieved a membership of more than 1000 pharmacies in 20 states during his thirteen-year tenure as Executive Director.

Tony graduated as a pharmacist from St. John's University in 1962. He was the owner and operator of a small chain of independent pharmacies in the New York suburbs until 1980, when he sold that company to concentrate on the development of the Legend network. Tony is a member of numerous pharmacy trade organizations encompassing many different practice settings and serves as a Director and/or Advisory Board member of a number of healthcare companies, both in the United States and in the United Kingdom.
PHARMACY VALUATIONS AND THEIR IMPACT ON EXIT STRATEGY PLANNING

How current industry activities are impacting on pharmacy valuations

Tony De Nicola, RPh
President, Buy-Sellapharmacy.com
NCPA Annual Meeting
Anaheim, CA
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OUR DISCUSSION TOPIC

PLANNING FOR THE SUCCESSFUL TRANSITION OF A PHARMACY TO A NEW OWNER AND ALL THAT THE PROCESS ENTAILS

THE CHANGING RETAIL ENVIRONMENT IN PHARMACY

• INDEPENDENTS  40,000  30,000  22,000  22,000
• CHAINS  10,000  15,000  25,000  21,000
• SUPERMARKETS  -----  3,000  8,000  12,000
• MASS MERCHANTS  -----  2,000  5,000  6,000
• HOSPITAL OUTPATIENT  -----  100  2,500

*1985 was the year that mail order pharmacy first became a factor in pharmacy providing in the U.S.
** U.S. Outpatient & Community Pharmacy Market Review – The Thomsen Group
FACTORS WHICH CREATED THESE CHANGES

- SHRINKING MARGINS
- POWERFUL COMPETITION
- MANAGED CARE ACTIVITIES/PBM
- AGGRESSIVE ACQUISITION ACTIVITY BY THE CHAINS
- MANDATORY MAIL ORDER
- LACK OF INTEREST IN RETAILING BY MANY NEWER GRADUATES

1980 – 2000 OWNERSHIP TRANSITION OBSTACLES

- Stores were sold for less than their true value
- Stores were sold to chains by owners who lacked knowledge of the market, hadn't planned for an exit
- Stores were closed up by owners who couldn't find viable buyers
- Young pharmacists took the "easy route" to earning money, going to work in the chains for big salaries and not considering independent ownership a viable means of practicing their profession

WHO IS BUYING INDEPENDENT PHARMACIES TODAY?

- Employee pharmacists, first-time buyers who want to be their own boss, do it their way
- Existing owners who want to go multiple, leverage expenses and build a small chain of their own
- Former owners who miss owning their own businesses
- Investment groups of various types, particularly those with specialty pharmacy interests
- The chains, corporate pharmacy groups who want to increase their market share, make new units productive
OPPORTUNITIES FOR EXISTING OWNERS

• To sell their pharmacy to another independent operator for a fair price, with good terms.
• To maximize the value of the business, cash out, and turn that value into money to fund retirement or other business activities.
• To see the business you have built survive into the next generation.

WHAT DOES THIS PROCESS/ACTIVITY REQUIRE?

Intelligent and thoughtful planning for the future with a sharp eye on the many details that exit strategy planning encompasses. The timing window for this process could be as long as ten years!!

CRITICAL TIMING WINDOWS

• Ten Years – Corporate structure, rights to the premises
• Five Years – Condition of the financial statements and balance sheet
• Three Years – Business valuation and ways to enhance it, rights to the premises
• One Year – Marketing strategy and finding the buyer
ISSUES TO BE ADDRESSED BY PROSPECTIVE SELLERS

• What is the true market value of my pharmacy?
• How can I financially document/demonstrate that value?
• How can/should the transaction be structured?
• What kind of professional help is required?
• Who is a qualified buyer?
• How can I find that buyer?

ISSUES TO BE ADDRESSED BY PROSPECTIVE SELLERS

• What is the best timing for marketing a pharmacy?
• What are the steps in this process?
• What will happen to the owner AFTER the business is sold?
• What is a “good” offer?

WHAT’S THE BEST THING YOU CAN DO?

ADDRESS THESE ISSUES WITH CAREFUL PLANNING, THE UTMOST CONFIDENTIALITY, THE ADVICE OF TRUSTED ADVISORS AND FAMILY MEMBERS AND A COMPLETE LIST OF DETAILS TO ATTEND TO PRIOR TO MOVING FORWARD
WHAT'S THE WORST THING YOU CAN DO?

ADDRESS THESE ISSUES WHEN YOU ARE UNDER PRESSURE OR STRESS FROM OUTSIDE INFLUENCES, FINANCIAL PROBLEMS, LEGAL PROBLEMS, FAMILY PROBLEMS, POOR HEALTH, PENDING NEW COMPETITION, ANY MAJOR EVENT THAT MIGHT IMPACT ON VALUE IN THE SHORT TERM

THE PARAMOUNT ISSUE TO BOTH SIDES OF A DEAL

WHAT IS THE VALUE OF THE BUSINESS AND HOW CAN THAT BE DOCUMENTED TO THE SATISFACTION OF ALL PARTIES TO THE TRANSACTION?

As an owner, shouldn't you know the value of your business BEFORE you attempt to sell it?

PHARMACY VALUATION.. THE QUESTION OF THE AGES

- A multiple of cash flow or some other profitability measurement.
- A percentage of annual sales.
- A fixed dollar figure times the number of prescriptions filled (weekly, monthly, annually).
- A multiple of the owner’s total compensation (ODP).
- A comparison against other transactions of a similar nature.
MARKET VALUE vs. MARKET PRICE

Market Value = The value ascertained by using one or more of the formulas that can be applied and/or by comparing against other transactions of a similar nature.
Market Price = What someone is willing to pay for a pharmacy, regardless of stated or documented value.

TO OBTAIN THE VALUE, ONE MUST....

• Review current and historical financials, at least three years if available.
• Review Rx department statistics to determine the mix of business.
• Review purchase records to help determine gross margins.
• Review expenses to determine true operating costs.

WHAT DO BUYERS NEED? CRITICAL FACTORS TO MAKING A DEAL WORK (THE BIG THREE!!)

• The ability to draw a managerial salary commensurate with their work efforts.
• The ability to earn a return on any cash investment they make equivalent to or better than current market returns.
• The ability to service any debt incurred in the course of the transaction.
WHY ARE THESE CRITICAL?

• The Seller = Can demonstrate to the buyer why the business is worth what he/she says it is and how it can be paid off. Particularly critical when the seller is providing financing of any kind.

• The Buyer = Will feel comfortable that when he/she assumes ownership they will
HOW DO BUYERS AND SELLERS CONNECT CONFIDENTIALLY?

• Through advertising, store owner advertises the business for sale, fields inquiries from buyers.
• Via referral from a professional colleague or friend.
• By direct contact in the pharmacy.
• Through business consultants/advisors who participate in the pharmacy buy-sell process.

TRADITIONAL DEAL STRUCTURE

• Purchaser contributes a certain amount of equity, usually a minimum of 15-20%.
• The balance is financed over some reasonable period of time which often (but not always) matches the term of the lease.

SOURCES OF FINANCING

• The seller holds the note/mortgage over an agreed upon term, collects principal and interest monthly.
• A bank lends the balance due after down payment to the buyer, not unlike a home mortgage (usually an SBA guaranteed loan).
• A wholesaler participates in a limited way, or guarantees the note.
• A personal loan from a friend or relative.
ISSUES TO ADDRESS

• Execution of a formal contract/purchase agreement
• Negotiation of a lease or assignment of existing lease.
• Application for the necessary licenses, third party provider agreements and provider #s.
• Addressing employee transition issues
• Arrangements made for inventory to be taken.

HOW LONG DOES THIS PROCESS TAKE?

While there is no set timing, 8-12 months is the average “sales cycle” for the sale of an independent pharmacy, with many transactions taking significantly longer than one year!!

CONCLUSIONS

• The process takes careful planning.
• The process requires extensive preparation.
• The process requires support and input from others and professional guidance.
• The process can be stressful.
• The process takes time, requires patience.
AT THE END OF THE PROCESS THE BUSINESS WILL HAVE BEEN SOLD SUCCESSFULLY AND THE SELLER WILL BE ABLE TO ENJOY THE PROCEEDS OF THE SALE WHILE THE BUYER BEGINS TO DISCOVER THE MANY BENEFITS OF OWNING HIS OR HER OWN BUSINESS

QUESTIONS??
COMMENTS??
DEBATE??
Learning Assessment Questions


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1. Internally prepared, handwritten financial statements will be sufficient for the vast majority of people interested in purchasing a pharmacy.
   
   TRUE ________             FALSE __________

2. When planning to sell a pharmacy, how much time should the prospective seller allow for the process to be completed?
   
   a) six weeks
   b) six months
   c) at least a year
   d) more than a year

3. The best way to find a buyer for a pharmacy is:
   
   a) Ask my wholesaler’s salesman if he or she knows anyone who might be interested.
   b) Ask my friends when I see them at local pharmacy association meetings.
   c) Advertise the business for sale in the local newspaper.
   d) Advertise the business for sale in the Wall Street Journal.
   e) All of the above.
   f) None of the above.

4. A prospective buyer for my pharmacy will expect to:
   
   a) Earn more money the first year they own my store than they ever did as an employee.
   b) Earn a return on their investment of at least 25% annually.
   c) Be able to satisfy any debt incurred in the transaction from the cash flow of the business.
   d) Fully expect me to carry the mortgage and, if I own the building, provide them with at least six months’ free rent after they close the deal.

5. The Medicare Part D prescription plan has had a positive effect on the gross margins of the average independent pharmacy.
   
   TRUE ________             FALSE ______________
Learning Assessment Answers


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Answers:
1. False
2. c
3. f
4. c
5. False