Keeping Independents Independent: Junior Partnership

Keeping independents independent is a goal for NCPA. However, that task seems to be increasingly difficult for a number of reasons. One is that many current independent owners wait until they are ready to retire to plan the sale of their pharmacy. Their retirement is tied up in their pharmacy, and they want the cash now. On the other hand, many pharmacists who want to become owners don’t have the financial means to purchase a pharmacy outright.

One alternative to the direct sale is a junior partnership. It takes a little planning, but in the end can result in a win-win-win for the pharmacy owner, the buyer, and independent pharmacy. In this situation, the sale of the pharmacy occurs over several years, with the new owner acquiring a gradually increasing percentage of ownership in the pharmacy while increasing his or her share of the management.

The junior partnership example described in this article provides the owner or potential buyer with a practical guide as to how the transfer of ownership of a community pharmacy may be accomplished in a situation where the buyer has little or no capital. Factors such as the time frame, percentage of purchase per year, and amount paid may be adjusted to meet special needs of the owner or purchaser.

All provisions of the junior partnership should be agreed upon in writing by both the owner and junior partner. This agreement may be drawn up by an attorney. The description of the current example may serve as a guide. Particular attention should be given to provisions that would allow the owner or the
junior partner to terminate the agreement should particular situations develop. In the event a portion of the pharmacy had been purchased by the junior partner at the time of termination, provisions should be delineated to describe the disposition of the junior partner’s share, i.e., would it be sold back to the owner and, if so, how would the purchase price be determined?

Tables 1 and 2 show how a transfer might be structured to allow the purchase of a pharmacy over an extended period of time. In this example, the pharmacy has annual sales of approximately $2 million. The agreed upon purchase price is $458,125. Adjustments will be made each year to reflect an increase in the value of the pharmacy.

The "Income to Owner" table, see Table 1, shows an estimated 6 percent increase in the value of the pharmacy each year, which affects the incremental payment the junior partner will make to purchase the pharmacy. The partnership agreement calls for the junior partner to receive an annual salary of $64,000 plus a $10,000 bonus each year as an incentive to stay with the firm. Salary increases would be provided each year as allowed for in the junior partnership agreement.

In this case, 50 percent of the pharmacy is purchased over a six-year period, at approximately 10 percent per year. After the sixth year, the junior partner could purchase the other 50 percent using a bank loan, owner financing, or the same procedure as for the first 50 percent. In our example, the junior partner pays for and receives the first 10 percent of the pharmacy after the second year of the agreement, which gives her two years to save for the purchase of the initial 10 percent. After years three through six of the agreement, 10 percent is purchased per year based on the valuation of the pharmacy at that time. In this agreement, the junior partner will actually pay for only five percent of the pharmacy at the end of each year in which a payment is due. An additional five percent will be provided by the owner at no charge as an extra incentive for the junior partner.

The most significant bottom line figure in this scenario is the difference between what the owner would be giving up by not instituting a junior partnership plan, but rather accepting a lump sum cash buyout offer from a chain of $458,125. Under the junior partnership arrangement, the owner would have accrued over $689,887 through payments from the junior partner and net profit participation. In addition, the owner, at the end of the sixth year, would still have a 50 percent stake in the pharmacy for another $324,929, yielding a total of $1,014,816.

Contrast that amount with the $458,125 buyout figure, and even if that $458,125 somehow avoided hefty taxes and was invested for six years at 5 percent interest, the accrued amount of $613,931 would fall far short of the junior partnership arrangement by $400,885.

Thus, the junior partnership deserves significant consideration in a pharmacy owner’s business plan.

**Table 1. Income To Owner From Net Profit And Purchase Payments**

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<thead>
<tr>
<th>Year</th>
<th>Phar. Value</th>
<th>Jr. Partner % Own</th>
<th>$ to Seller</th>
<th>Net profit</th>
<th>Seller % Own</th>
<th>Seller NP $</th>
<th>Total to Seller</th>
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<tbody>
<tr>
<td>End YR1</td>
<td>485,613.00</td>
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<td>95,400.00</td>
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<td>514,749.30</td>
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<td>25,737.46</td>
<td>101,124.00</td>
<td>100%</td>
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<td>545,634.20</td>
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<td>578,372.30</td>
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<td>119,817.00</td>
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<td>610,074.60</td>
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<td>120,440.00</td>
<td>80%</td>
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<tr>
<td>End YR6</td>
<td>649,859.10</td>
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<td>127,667.00</td>
<td>70%</td>
<td>109,093.00</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Income from Net Profit</th>
<th>Annual Bonus</th>
<th>Profit + Bonus</th>
<th>End of Year Payment to Current Owner</th>
<th>Amount to Save Monthly to Avoid Borrowing</th>
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Profiles in Ownership

LONNIE MEREDITH
Mentoring Makes A Difference

"Don't be afraid," Lonnie Meredith, R.Ph., advises fellow pharmacists contemplating the great first leap into ownership. As his mentor told him, "There's not many professions that you can go broke in and not be successful and still find a job that pays close to six figures. So, there's not really anything to be scared of."

Meredith is successful, thanks to his commitment and energy and the support of that mentor, Doyle High. Meredith answered High's ad in the state pharmacy association journal to work for him in Haskell in the rolling plains of northeast Texas. They served patients together for nine years in the county with the oldest average age residents in the state before Meredith purchased The Drug Store.

“We roughly followed the junior ownership plan,” Meredith says. He borrowed some money from his family and also from the store’s retirement fund. High held a majority of the paper, and there's about three years left on the note.

Although High had made him de facto owner before the official transfer, “It’s just a different feeling knowing that you’re responsible for everything. He pretty much let me do as I wanted. We planned on this for several years. So, I ran it as if it were mine to get a feel for it. But until your name is on the bottom line, it’s a lot different.”

Now he’s filling a few more than 200 prescriptions a day in his 4,000-square-foot pharmacy and gift shop. Last April he went to a compounding course offered by the Professional Compounding Centers of America and is just starting to get that niche off the ground. He’s billing Medicare for inhalation therapy and diabetes strips and also is going to start shoe-fitting soon. Certainly the most critical service he provides is arranging delivery for prescriptions to four other towns in a 20 to 30 mile-range that have lost pharmacies.

When he was at the University of Texas College of Pharmacy, his only practical exposure to independent pharmacy was a single management class. "I think that’s something schools need to address," he says. A 1999 graduate of NCPA’s Ownership Workshop, Meredith highly recommends it. "Anyone who’s even remotely interested,” he says, “needs to go through that.”

CHAD SHEDRON
From Residency To Ownership

When he was finishing pharmacy school at Butler University, Chad Shedron figured he would be buying his first independent pharmacy when he was 35 or 36. But there he was, 27-years-old in June 2001 signing a financing agreement with a local bank in West Lafayette, Indiana, and wondering if he’d done the right thing.

First, he wasn’t buying just any independent pharmacy. It was Family Pharmacy, the widely recognized model for community pharmacy practice established by Dennis McCallian, Pharm.D., to serve as a “living laboratory” for pharmacy and site of the first accredited community pharmacy residency program.

Then, there were the two-year-old triplet girls he and his wife have to think about. He knew they'd be joined by another sibling in a few months. (Their sister was born in September 2001. That makes four girls under four, if you’re counting.) But Shedron had completed his residency at Family Pharmacy, had served as program preceptor, and liked the modern apothecary-style pharmacy that concentrated on prescriptions, counseling, and compounding.

“I’ve probably enjoyed it more than I thought I would,” he says, “even with the hours you have to put in. Sales are up 30 percent. We just had a great first year. I honestly don’t have too much to complain about.”

There were no complaints about financing to transfer ownership, either, with a good business plan and presentation for the bank bolstered by McCallian’s record of strong growth trends over nine years. “Buying an existing practice, it was obviously easier getting financing than a start from scratch pharmacy,” Shedron says.

He is continuing the progressive practice of the founder. He averages about 80 prescriptions a day, leaving ample time for office appointments with patients to help them better manage their conditions. Very few students from nearby Purdue University are patients, but a number of the faculty are.

“The average middle class family, mom and dad and a kid or two are the heart of our practice,” according to Shedron. The patient education appointments most often deal with asthma, diabetes, dyslipidemia, hormone replacement therapy, and associated tests. They give immunizations and do general consultations on drug therapy.

“At least consider ownership as an option,” he urges. “The more pharmacists we have who control their own destiny, rather than being just another employee, the better it is for the profession. Here, we set our own standards. If I want to add another special service,
we do a little work on it, see if it’s worthwhile or not, and do it. We don’t have to talk about it and sit around thinking about it for six months. We can jump on things more quickly and be more flexible.*

Shedron also is a strong advocate for community pharmacy residencies to inspire the next generation of independents. “I knew this is what I wanted to do when I did my residency,” he recalls. “It really turned the corner for me. Ownership was what I wanted to get into.”

ANNE BARR
Competition Came With The Territory
Anne Barr cheerfully tells a caller, “I’m where the bread used to be.” That’s because her pharmacy is just inside the front door of a long-established and recently expanded grocery in Savannah, a small town in northwestern Missouri where the Pony Express and wagon trains once headed out across the hostile plains.

Consider An ESOP, It's No Fable
Michael Boyd carefully evaluated all the options for cashing out of Red Oak Drug, Inc., his independent pharmacy 20 miles south of Dallas, before taking the Employee Stock Option (ESOP) route. “I was extremely thorough in my investigation because I wanted what was best for my family, the employees, and the company,” Boyd says. “When I assessed the pros and cons of a sale to the ESOP versus a sale to a national provider, there was no comparison. The ESOP enabled me to defer hundreds of thousands of dollars in capital gains tax, avoid third-party purchase negotiations, enhance the value of the company by more than 30 percent, preserve jobs, and reward employees with equity ownership.”

Boyd turned to the investment banking firm of Roland, Criss & Co., Ltd. with offices in Dallas, Chicago, and Denver to structure the deal. “There is a misconception that this sale strategy is only for large companies,” says Ron W. Hagan, managing director of strategic advisory services for the firm. “The most qualified buyers of America’s small-to-middle market companies are the people who run them day in and day out.”

ESOP’s were created by Congress almost 30 years ago, but they remain largely unknown to most business owners and their employees. According to Ronald, Criss, & Co. these are among the major benefits:

- If the company is structured as a C-corporation, shareholders may defer capital gains taxes on the sale proceeds. (S-corporation shareholders can use an ESOP for ownership transition purposes.)
- Employee owners do not buy stock; they earn it through a vesting schedule.
- Employee owners defer taxes on the stock they earn.
- ESOP buyout debt is fully tax deductible for corporate income tax purposes.

Boyd’s employees helped build the value of the pharmacy company over 15 years—now they own it. “In their minds, they are owners,” Boyd observes. “They now see that their decisions impact the value of the company, which, in turn, impacts the value of their stock. I am proud of the platform for success we’ve created over the years. However, I am even more excited to see the production of inspired employees over the coming years.”

October 8, a clinic pharmacy that had been in a doctor’s office moved into a new building directly across the street. About 10 miles away, there’s a mammoth Wal-Mart Super Center complete with a pharmacy.

The grocery store had long courted Barr to open an independent pharmacy inside, but it wasn’t until some new owners came along that “it just seemed right and I took a leap. Actually, it was an easy decision. Everything just fell into place.”

For financing, she turned to the Small Business Administration (SBA). “It took a little doing to get a loan, but it wasn’t too horrible,” Barr says. “I was able to refinance my house and get the SBA loan without having to ask family or anyone else for help.*

The pharmacy area is about 600-square feet in the Country Mart grocery store, and there Barr has a Diabetes Shop, and offers cholesterol tests, and some compounding. Scripts are gradually increasing, and she filled about 45 a day in August. She gave about 140 immunizations last flu season and hopes to give at least as many this year. ‘A lot of people said they’d come back,’ she recalls, ‘because [they said] it was the shot they had in their life that hurt the least.’ She also put on a successful health fair that will become an annual event.

“It’s taking me longer to break even than I thought it would,” she admits. “In order to do so, I’ve worked six-day weeks. I didn’t realize how tired I’d get. I think I’m just about there [breaking even].” Sometimes she wishes she’d paid more attention to the financial end of independent pharmacies when she was an employee.

Barr says she’s been taking patients away from her competitors with convenience, faster service, and a more comprehensive prescription stock. “I’m doing more of what they predicted [at the NCPA Workshop],” Barr says. “I’m breaking even after a year.” The workshop, she continues, was a big help even though, “I’m sure I’m not doing a lot of the things I learned.” One thing was certain after the workshop, though. “I knew I’d hate the bookkeeping,” she says. Fortunately for her, “my husband likes it.”