Pharmacy Valuation/Junior Partnership Establishment

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BASIC GOALS:

- To enable the pharmacy manager/owner or potential owner to determine an equitable selling/purchase price for an established community pharmacy.
- To provide the pharmacy manager/owner or potential owner with the ability to design the framework and details for the establishment of a junior partnership providing for the transfer of ownership for a community pharmacy over a desired number of years.
Determining an Equitable Selling/Purchase Price
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
- How Badly Seller Wants to Sell
- How Badly Buyer Wants to Buy
About Using Formulas

- General in Nature
- No Single, All-Purpose Formula
Adjustments to Financial Data “Normalizing”

- Owner’s Salary
- “Personal” Expenses
- Depreciation
- Interest
Formulas for Outright Sale Do Not Include

- Cash
- Accounts Receivable
- Accounts Payable
- Notes Payable
## Case Study
### Financial Data

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>$180,000</td>
</tr>
<tr>
<td>Fixtures/Equipment</td>
<td>$30,000</td>
</tr>
<tr>
<td>Owner Salary</td>
<td>$120,000</td>
</tr>
<tr>
<td>Net Profit</td>
<td>$90,000</td>
</tr>
</tbody>
</table>
Formulas for Valuation
Sales Projection

(.25) ($2,000,000) = $500,000
Return (Net Profit) on Investment (Purchase Price)

\[
\text{.20} \times \text{(Purchase Price)} = \text{Net Profit}
\]

\[
\text{.20} \times X = \$90,000
\]

\[
X = \$450,000
\]
Direct Assessment (Bank of America)

Tangible Assets

- Inventory $180,000
- Fixtures/Equipment 30,000

$210,000
Direct Assessment

- Earning Power (10%) $21,000
- Salary if Manager Elsewhere $100,000

$121,000
Direct Assessment

- Net Profit: $90,000
- Owner’s Salary: $120,000
- Total: $210,000
Direct Assessment

Extra Earning Power

$210,000

- 121,000

$ 89,000
Direct Assessment

Intangible Assets = (Extra Earning Power) \times (Years of Profit Factor)

\((\$89,000) \times 3 = \$267,000\)
Direct Assessment

- Tangible Assets: $210,000
- Intangible Assets: $267,000
- Purchase Price: $477,000
Percentage of Sales Plus Inventory

\[(0.15)\text{(Sales)} + \text{Inventory} \]
\[(0.15)(\$2,000,000) + \$180,000 = \$480,000\]
Net Income Approach

1.5(Net Profit + Owner’s Salary) + Inventory
1.5($90,000 + $120,000) + $180,000 = $495,000
Net Profit Approach

5 (Net Profit)

5 ($90,000) = $450,000
Itemization

- Inventory + Fixtures and Equipment + Goodwill
  $180,000 + $30,000 + 1.5($90,000) = $345,000
$7 per prescription filled annually + inventory

($7) (# prescriptions filled annually) + inventory

($7) (50,000) + ($180,000) = $530,000
$10 times annual prescriptions

\((10 \times 50,000)\) = \(500,000\)
Summary of Valuation Formulas

- Sales Volume: $500,000
- Return on Investment: $450,000
- Direct Assessment: $477,000
Summary of Valuation Formulas
Outright Purchase

- Percentage of Sales Plus Inventory: $480,000
- Net Income Approach: $495,000
- Net Profit Approach: $450,000
- Itemization: $345,000
- $ Per Prescription plus Inventory: $530,000
- $ Per Prescription: $500,000
Summary of Valuation Formulas

Outright Purchase

- Range: $345,000 - $530,000
- Average: $469,667
Establishment of a Junior Partnership ($500,000)

- 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 1)

- 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: $158,346
- Owner’s share of profits: $544,802
- Remaining 50% of pharmacy: $354,629

Total: $1,057,777
Payments of Junior Partner (Figure 2)

- Paid from bonus and net profit share
- Save $170/mo. in years 1 and 2 and $588/mo. in year 3 to avoid borrowing