Buying and Selling a Pharmacy—The Art of the Deal

How to minimize stress, reap rewards

By Tony De Nicola, R.Ph.

In a positive and growing trend, more pharmacists want to own their own businesses than at any time since the 1980s. With today's independent owner demographic being what it is (predominately male, more than 60 percent over age 55), there couldn't be a better time to buy a community pharmacy.

With so many new and exciting market niches and opportunities presenting themselves, independents can and will not only maintain their current share of the market but, in my opinion, be able to grow it by being innovative, changing with the times, and just plain competing for the customer. Senior executives in large drug chains have expressed time and again the fear of competing against the "new" independent. They are comfortable competing against each other, because they are all more or less alike in product mix and service offerings. What they can't compete successfully against is the unknown of an assertive, service-oriented pharmacy professional who not only owns the business, but is on the premises and servicing the customers.

I believe that this combination of factors, coupled with the increased prescription utilization by all population segments, will lead to even higher volumes and more gross profit dollars than ever before. In fact, a brief look back over the past two decades indicates that despite the margin pressures (which will continue, no doubt), despite mail order (which clearly has a place in the market), despite the mergers of the giant chains (which can only continue for so long and, in fact, are probably good for independents), sales volume and gross profit dollars continue to increase. One of my favorite sayings has always been that "you don't bank percentages, you bank dollars." Always remember that when thinking about buying a pharmacy.

Not Simple, Yet Rewarding

Buying or selling a pharmacy is never a simple matter. The process can be stressful for both sides, often leads to difficult hurdles which must be overcome but, at the end of the day, can be most rewarding for a buyer and a seller. If you are a prospective owner, look hard for a pharmacy to acquire. There are many options, depending upon a multitude of factors, but clearly, with so many stores available and changing hands, there is one out there for you to purchase.

When a prospective buyer has successfully identified a pharmacy he or she wishes to purchase, and perhaps even negotiated a transaction which with they are comfortable, the first major issue to address is the financing (possibly the only factor that might stand in the way of the deal). It is rarely the case that younger pharmacists, who have spent a number of post-graduation years retiring student loans and other debt incurred to help finance their education, are flush with cash and ready to purchase a business. Accordingly, they will require financing of some kind, from somewhere, to help them achieve their ownership goals.

Financing issues, while often somewhat complex, can be distilled down to two core premises:

- Sellers want to be sure that they will receive all the proceeds of any sale that is made.
- Buyers, particularly first time buyers, rarely if ever have the money required to pay for their proposed acquisition in cash.

These two premises lead to the more complex issue of how pharmacy acquisitions, and small business acquisitions in general, are financed. To begin, let's assume that the buyer will probably not have the full purchase price in hand and therefore will have to borrow to finance the acquisition. There are three more or less "traditional" sources of this financing, including:

- Banks and other financial/lending institutions
- Personal funds of relatives or friends
- The business's seller

Traditional bank financing, whereby the borrower posts some sort of collateral for the loan, then receives the funding required to buy a business, is not the norm in the world of small business acquisitions. Since the collateral available in a retail pharmacy acquisition rarely, if ever, equals the value of the required loan, most commercial banks and other lending institutions are not comfortable lending a significant portion of the purchase price. This is particularly true in the case of pharmacy acquisitions, where so much of the value is in the goodwill attached to the reputation of the pharmacy and the customer relationships that reside, in actuality, in the prescription files.

SBA Loans

The most notable exception to the rule is a government guaranteed SBA (Small Business Administration) loan. In this scenario, an authorized SBA lender, of which there are many, provides the funding required for the acquisition (as much as 85 percent to 90 percent). A significant portion of the loan is guaranteed by the federal government, thereby reducing the risk of loss to the bank should the new owner fail in business. This process is not as mysterious as many would make it out to be, and is done every day in the United States, subject to a number of terms and conditions for both the buyer and the seller, all of which can be met. These include:

- A "reasonable" equity contribution by the buyer, somewhere between 10 percent and 20 percent of the total deal. If there is real estate involved in the transaction, whereby the buyer is also purchasing a building from the seller, this can lower the equity contribution required.
- A professional evaluation of the business to support the value and payment price
- Complete financial documentation from both the buyer and the seller, and a reasonably complex set of forms that must be completed
- The posting of additional collateral other than the assets of the business, usually in the form of a lien on the buyer's home, assuming he or she owns one
- The personal guarantee of the purchaser(s)

While this may sound somewhat complex to a first time buyer, it is a fairly routine process. It can be accomplished with help from a qualified professional experienced in guiding people through the process and has the necessary banking relationships to make it happen.

The second financing method, borrowing money from family or friends, is often fraught with complications, as personal relationships can and do cloud good business judgment and may lead to difficult situations. With that said, there are young pharmacists who have the good fortune to have family or friends with capital available who will support them in the acquisition of a business. My counsel here is to treat these loans as formally as possible, clearly documenting the responsibilities of the borrower to pay back the money, under specific terms and within a specific time frame. In this way, misunderstandings about the term of payback, interest rates payable, and default provisions can be avoided.

Holding the Note

The third method, and probably the most widely used since this activity first began, is for the seller of the business to hold the note from the buyer, or to "take back a purchase money mortgage," to use the popular vernacular for this activity. In this scenario, not dissimilar to bank borrowing, the buyer puts up a down payment, as much as the parties agree is required (but rarely less than the value of the inventory in the pharmacy), and the seller holds a note for set period, at an agreed upon rate of interest and payment intervals, which the buyer proceeds to pay once the transaction is closed.

The benefits of this type of borrowing for the purchaser are the lack of paperwork and professional fees required for a bank loan (though the sellers usually require documentation of the buyer's personal financial situation and a formal credit check). If the parties agree on all points, the loan is a done deal. There is no need for government guarantees, bank credit officers' approvals and other requirements which can slow down, impede, or kill a deal. From the seller's perspective, these loans pay interest at market rates, providing a reasonable return on investment for them, and regular monthly payments. It provides a steady income, assuming they don't need or want to receive all the proceeds of the sale at the time of closing. Often it provides some tax benefits since the note holder is not receiving the entire proceeds in one tax year.

Regardless of which financing option(s) may be available to a buyer, there is usually always a requirement for a "reasonable" equity contribution or down payment on the buyer's part. While this amount can vary widely, a good rule of thumb is that at least 20 percent of the total purchase price will be required from the buyer to qualify for financing from a third party, bank, current owner, or a family member. Simply put, this means that if a pharmacist is contemplating buying a business for $750,000 (more or less the mean/median transaction size today), he or she will require at least $150,000 in what is known as "unencumbered equity capital" to qualify for financing.

Accumulating a Nest Egg

If your goal upon graduation is to own your own pharmacy within a certain period, you must begin to accumulate this equity capital, an "acquisition nest egg" so to speak, to properly position yourself to purchase a business when the right opportunity comes along. Having the necessary down payment and the confidence that one of the three financing methods described in this article will be available to you is essential when negotiating the transaction. Rarely, if ever, do opportunities present themselves to acquire pharmacies, or any businesses in the small business environment, without an equity contribution on the part of the purchaser.

Creating this nest egg is a process that requires a significant amount of discipline on the part of the prospective purchaser. The good news today is that pharmacists' salaries have never been higher and continue to increase, due to the basic economic premise of supply and demand. You (and any potential partner you may be connected to, in business or in life) should create an organized plan to accumulate the capital you will need to become a business owner, if that is your goal. Having that capital will make you what is known as a "qualified buyer," one who has the professional experience, operating expertise, good credit record, and the necessary down payment. These factors are what all lenders examine when providing the remainder of the funds necessary to purchase a business.

There are many ramifications to the various transaction financing methods, all of which should/must be explored by both buyers and sellers prior to negotiating and closing a deal. It is important to seek the advice of qualified professionals who are familiar with these types of transactions, such as attorneys, accountants, financial counselors, and others who can explore the various financing methods and help guide both buyers and sellers in the proper direction. ☐

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