LET'S MAKE A DEAL

Independent pharmacies are catching the eye of investor groups

Carol Uken

Independent pharmacy owners walked through the Valley of Death in the 1990s when it seemed as if pharmacy benefit managers and their mail-order minions would kill off community pharmacy. It’s true that thousands of weaker independents did, indeed, succumb, but the leanest and meanest survived, and today, they are a hot commodity on the buy-sell market.

After 29 years in hospital pharmacy, Dan Boulanger and his wife, Margaret, a nurse, had been talking about owning their own pharmacy when he heard that English Drug in Bethel, Conn., was up for sale. They took the plunge and purchased the pharmacy last July and opened it under their ownership on Sept. 1.

"Just going through the whole procedure was eye-opening," said Boulanger. "The expectations and projections are not necessarily the reality because of changes in the business climate due to things such as Medicare Part D and Medicaid. My advice is to make sure you have a lot of money for the start-up. The costs are phenomenal. But we are making a go of it. And the professional satisfaction is tremendous. People who knew me at Danbury Hospital say I look much more relaxed."

There are currently a lot more would-be buyers like the Boulangers than there are sellers, according to Tony De Nicola, R.Ph., president of Buy-Sellapharmacy.com, which has partnered with the National Community Pharmacists Association to try to keep independent pharmacy independent by matching potential buyers with sellers. His on-line pharmacy brokerage firm sold 27 pharmacies last year, but it would have moved even more, if more sellers had put their stores on the block.

"There's not enough good inventory of quality pharmacies to be sold," said De Nicola. "We have 10 times as many buyers registered with us as sellers."

There's also an upswing of interest in ownership among recent pharmacy school graduates, said Richard A. Jackson, R.Ph., Ph.D., professor of clinical and administrative sciences and director of the center for community pharmacy practice and research, Mercer University Southern School of Pharmacy. He teaches an elective pharmacy ownership course to 66 students who are all there because they want to be. "They've seen several of our grads go out and open a pharmacy and be successful," he said. "One of our graduates owns four pharmacies, and he's a young guy. It's good that these students can see young people succeeding, not old codgers like me."

There is an "amazing amount of interest" in pharmacy ownership at pharmacy schools, said Douglas Hoey, NCPA's chief operating officer, who noted that when he did campus outreach 10 years ago, maybe four or five students would
approach him after a presentation. Now, when NCPA officials give a lecture on campus, 20 to 25 students crowd around the lectern asking about ownership.

But it’s not just students who are interested; pharmacy alumni a few years ahead of them are ready to take the plunge into ownership, said Hoey. Recognizing the potential to increase its membership rolls, NCPA targets outreach to young pharmacists who may be “disenchantment with their practice setting because it’s not what they expected,” he said. “Independent pharmacy is the place where they decide how much time they want to spend with patients and counsel on their own terms. The freedom to practice as they wish is a big factor. In our surveys, financial rewards are middle to low on their list but being able to have autonomy in how they practice is right up there.”

Wheeling and dealing
The typical owner looking to sell a pharmacy is a white man over the age of 55 who is getting ready to cash in his chips, said De Nicola. “He’s ready to retire to a condo, play more golf, and spend more time with the family,” he said. “That’s the bulk of sellers, but then there are the disgruntled owners who are just unhappy and those who are unsuccessful businessmen.”

The first-time buyer of a small to medium pharmacy tends to be a male pharmacist between the ages of 30 and 40 who wants to get out of the chain rat race and spread his entrepreneurial and professional wings. Although the majority of would-be buyers are men, more and more women and pharmacist couples are taking the plunge, said De Nicola. “I don’t want to be negative about chains, but it’s not the most fun practice setting,” he said. “It’s high pressure, no decision-making on your own, without a lot of free time. All you do is count, pour, lick, and stick. So the unhappy chain pharmacist who has been working 10 years says, ‘I don’t want to do this the rest of my life, I have better ideas. I want to own my own business.’”

In recent years a new breed of buyer has appeared on the independent scene: pharmacy owners who pool their resources to buy more pharmacies that become, in effect, non-chain chains, according to Guy Stillwell, R.Ph., president of the northern division of Hayslip & Stillwell Pharmacy Brokers. And he ought to know since he and two partners have so far purchased 12 pharmacies.

“Most of the low- to medium-volume pharmacies are sold to one operator,” he said. “The big pharmacies with $6 million or more in annual sales are out of the reach of a sole operator. Those stores are being bought by investor groups of pharmacists who own multiple stores. There’s a lot of absentee ownership.”

Individual R.Ph.s and groups of investors are still going up against the big guns of the drugstore chains when it comes to buying independent pharmacies, although chains have pulled back from the feeding frenzy of the ‘90s when many more independents were on the block. Still, the chains have the capital and cash to dangle in front of an owner who’s ready to sell, said Stillwell, who estimated that half of community pharmacy sales are to chains. Also working in the favor of the chains is the fact that many independent owners can’t find or don’t look for another pharmacist who wants to buy a pharmacy and has the financial wherewithal to swing the deal.

Bottom-line mentality
The top-of-mind question for every seller or buyer is, “How much is this pharmacy worth?” according to Stillwell, who said he gets phone calls from pharmacists every day seeking an evaluation. “They typically tell me two or three things about their pharmacy, such as, ‘Here are my sales, here’s how many scripts I filled, and here’s what my wife and I think we take out of the business,’” he said. “But the bottom line is that a pharmacy is worth what any buyer is willing to pay for it.”

Chains typically offer a multiple of the store’s annual Rx volume plus some, or all, of the inventory, said Stillwell. If, for example, a store filled 50,000 scripts last year, a chain offering $10 per script would pay $500,000, in addition to the value of whatever inventory it is willing to take off the outgoing owner’s hands.

“Many buyers and sellers often go to metrics to value a pharmacy,” said Stillwell. “The problem is that when people call me, I have to be honest and tell them the range is somewhere between $1 and $18 per script. And some pharmacies sell for just the inventory and nothing for the files.”

The dollar multiple of scripts per year is just one of more than a dozen ways for sellers and buyers to put a price tag on a community pharmacy, according to Jackson, whose paper “Determining an Equitable Selling/Purchase Price and Establishing a Junior Partnership for a Community Pharmacy” is posted on-line at http://faculty.mercer.edu.jackson_rfipship.htm. The formulas range from a price based on a percentage of annual sales, to return on investment, to income, to cash flow. Thus, depending on the formula used, the selling price of a pharmacy with $1.3 million in annual sales and 34,331 scripts could be as low as $244,092 or as high as $392,960.

Many experts seem to have their own preferred evaluation method. De Nicola finds buyers are willing to pay the equivalent of the pharmacy’s annual gross
profits. For example, a store that generates a 23% gross profit margin on sales of $2 million would be valued at $460,000. "In ballpark terms, we’re mostly seeing pharmacies sold for around 25% of one year’s turnover, plus the value of the inventory," he said. "But it’s all over the board. We sold one pharmacy last year for 50% of gross profits, one for 15%, and everything in between."

No matter how it’s sliced and diced, a pharmacy’s selling price will come down to about 20% of annual sales plus inventory, according to Larry Doud, CEO, Rochester Drug Cooperative, a regional wholesaler that fosters community pharmacy ownership in the Northeast. He added that one chain in his region is offering 17% of sales plus inventory, but an individual who owns 10 pharmacies has upped the ante by offering 24% of sales.

Stillwell’s favorite evaluation is what the cash flow will be in the new owner’s return on investment. “One pharmacist might think a 10% return on investment capital is a good return, but the next pharmacist may want a 60% return,” he said. “We try to get away from the idea that a business is worth a dollar multiple of the prescription files, because a compounding pharmacy may be worth $50 per script because the profit is so high. But a pharmacy that’s almost purely Medicaid may be worth a fraction of what the compounding pharmacy is worth."

Formulas alone cannot determine a pharmacy’s selling price, much as the Blue Book value of a used car has to be adjusted based on the condition of the vehicle being sold. That adjustment will depend on several other factors, according to Jackson, who is also a consultant on pharmacy ownership. The physical condition of the pharmacy, the level of competition, the composition and condition of the inventory, the economic trends in the community, the future outlook for retail pharmacy, the lease terms, the location, the pharmacy’s image in the community, and the terms of the sale must all be taken into account when calculating the value of a pharmacy.

If the real estate market is all about location, location, location, the same can be said of the buying and selling of community pharmacies. There are plenty of would-be buyers and there are a fair number of owners willing to sell, said Rochester Drug’s Doud. The problem is that the pharmacies on the market often don’t match the preferences of the people who are ready to buy.

South Carolina promotes community pharmacy ownership

A sign on the back of an 18-wheeler traveling the highway between Charleston and Columbia sparked an idea that led the South Carolina Pharmacy Association (SCPhA) to foster community pharmacy ownership.

“The sign on the truck read, ‘Student driver,’ and I thought that’s what we need—to put people behind the wheel of a real pharmacy,” said James Bracewell, SCPhA executive VP. His epiphany on the road from Charleston three years ago led to two initiatives: an elective course offering University of South Carolina College of Pharmacy students a real-world look at how independent pharmacies operate and a four-month hands-on learning experience for a pharmacist who pledges to open or buy a pharmacy upon completion of the fellowship.

The 14-week elective course brings students and their professor to SCPhA headquarters once a week to hear from and question people who deal with independent pharmacy, including owners, wholesalers, financial experts, and representatives from third parties. The curriculum is based on the work of Richard A. Jackson, Ph.D., of Mercer University Southern School of Pharmacy.

“There are about 50 USC students eligible to take one elective,” said Bracewell. “We thought if we had five or six students that first year, it would be great. We had 13 sign up. This year, we have 18. The course is really showing some payoff. One student from last year is buying a pharmacy from a pharmacist who wants to retire.”

The Community Pharmacy Institute (CPI) fellowship program offers a pharmacist-on-the-job learning three days a week in a preceptor’s community pharmacy. The owner agrees to open the pharmacy’s books and share information just as if the fellow were a junior partner, said Jennifer Burke, who directs both programs. Two days a week, the fellows work their way through Jackson’s course and develop a business plan. Time is also devoted to networking, such as spending a day with a pharmacy board inspector or with the Medicaid fiduciary.

In return for the practical experience, the CPI fellow must commit to open, buy, or participate as a junior partner in a community pharmacy at the end of four months. “These participants have stepped off the diving board,” said Bracewell. “They’ve quit their jobs and made a time commitment. Our first fellow opened her practice in a planned community last year, and this year’s fellow is already working on a land deal to be able to open her pharmacy this spring.”

The CPI program is being underwritten by four wholesalers: AmerisourceBergen, Cardinal Health, King Drug, and Smith Drug. In addition to partnering with the wholesalers, SCPhA is using its foundation to fund the scholarships. “The wholesalers realize we are making new customers for them,” said Bracewell. “They’re investing in their own future, but if they feel it’s not working, they can cut off their funding. But it is working.”

For more information about the SCPhA programs, go to www.scrx.org or phone (803) 354-9977.
“People who want to own drugstores don’t want to own drugstores where there are sellers,” said Doud. “We have three or four stores that are incredible buys, but we don’t have any prospective owners who want to go to those locations in northern New York. We can’t make people go where they don’t want to go, no matter how good the deal is.”

**So you wanna be an owner?**

Entrepreneurs-in-waiting who have their hearts set on owning a community pharmacy can try to buy one or open a new one. There are pros and cons to each approach. Some experts contend that in the current market, the price of existing pharmacies is so high, banks won’t lend on the value of a store’s goodwill, and most sellers don’t want to finance a big note for the buyer.

“You can start a store for $100,000,” said Doud. His Rochester Drug provides a would-be owner with store fixtures, a computer, and inventory up front to get the project off the ground. The new proprietor signs a note but has a six-month grace period after the store opens to begin paying off the 30-month loan at prime plus 2%.

“The average store in the NCPA-Pfizer Digest is doing $3.3 million a year in sales,” said Doud. “That store may be worth $1 million, and the $200,000 we offer in our line of credit isn’t enough to entice that owner to finance $800,000 for somebody that might end up being unable to run the business as well. And banks won’t loan a million bucks. So unless a person has significant money put away, he’s probably not going to be able to buy that pharmacy. In addition, buyers have to be well capitalized because of the length of time it takes third-party plans to kick in and to get cash flow straightened out, and at the same time support themselves.”

The best route to ownership for a young pharmacist is to purchase a pharmacy because its existing cash flow will keep the business afloat, said De Nicola. “A few people are starting a pharmacy, but without cash flow, it’s a high risk unless you’re in a setting that’s almost a guaranteed home run, such as a very large medical clinic with a lot of prescribing doctors where you think you’ll get lots of scripts very fast,” he said.

If starting a new pharmacy is too risky and buying one is beyond the budget, aspiring owners shouldn’t despair. There is a third way to ownership: the junior partnership that NCPA has been touting as a way for aspiring owners short on capital and owners seeking to keep their life’s work out of the clutches of the chains to both get what they want. In a junior partnership, the sale of the pharmacy occurs over a period of years as the buyer gradually accumulates an increasing percentage of ownership while assuming more of the management of the pharmacy, according to Jackson. The buyer makes regular payments to the owner, and they share the net profits. At the end of the period, the buyer owns the pharmacy free and clear and the seller ends up with more profit than if the pharmacy had been sold outright.

**Exit stage left**

Whatever their disagreements about the best way to price a pharmacy, there’s one thing the experts agree on: The biggest mistake independent owners make is their failure to look ahead to the day they can hang up their smock and enjoy the rewards of a lifetime behind the counter. Instead of waking up one day and deciding to put their pharmacy on the market, they need to formulate an exit strategy at least five years before they want to sell their pharmacy.

Several elements go into planning an effective exit, according to De Nicola. They include a thorough review of the pharmacy’s current financials, such as sales, profits, and trends over the previous three years. The owner should also get expert advice on how to improve the business in the short run to make it more attractive to a prospective buyer, while being realistic about the value of the pharmacy and understanding the timing and events that marketing and selling a business require. Last, and most important, he said the owner must develop a reasonable time line to make it all happen.

Owners need to work with their attorney and accountants at least five years ahead of time to set the stage for their exit, said NCPA’s Hoey. “Owners shouldn’t just wake up one day and say it’s time to sell,” he said. “Unfortunately, if owners don’t plan in advance, they’ll have to take whatever the chain offers. If they do plan, they can have several suitors.”

There should be a whole lot of exit strategizing going on right now, as 50% of today’s independent owners are over the age of 50. “So, in the next 15 years, there will likely be a huge turnover in ownership,” said Hoey.

There may be a lot more pharmacies with for-sale signs in the days ahead as owners nearing retirement age decide it’s time to cash out after discovering that the D in Part D stands for disaster. “My phone has been ringing off the hook since Jan. 3, with guys I met at seminars two or three years ago,” said De Nicola. “Part D implementation or nonimplementation is driving a lot of guys crazy.”