

Owner Transitions: Preparing You & Your Pharmacy to Sell

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Accredited for 1.75 CE Hours

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June 7, 2018
Hyatt Hill Country Resort, San Antonio

Disclosure & Session Objectives

Paid employee of American Pharmacies. Conflict of interest: None

Learning Objectives

At the end of this session; you will be able to:

- Explain the importance of setting owner goals for buying or selling;
- Identify important tasks to consider and accomplish in effecting the purchase or sale of a pharmacy;
- Explain basic formulas & methodology for determining the selling price of a pharmacy;
- Identify internal & external pressures that affect pharmacy performance, value & purchase price;
- Explain how adopting pharmacy best practices can positively impact the value of a pharmacy; and
- Describe the types of financing available to pharmacies & typical qualifications for loans.

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About RxLEGACY

- Created in 2016
- American Pharmacies' pharmacy ownership program, powered by AmerisourceBergen
- Sole objective is to keep community pharmacies community-owned
- Connects like-minded buyers, sellers and students
- Free resources, consultants & advice
- No exclusivity required
- Adept at the art of discretion

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RxLegacy Team Member: Role of APRx General Counsel

- Gather initial information
- Counsel best course of action throughout
- Match with interested parties
- Coaching on discussions with other parties
- Ownership transition advice
- Interaction with American Pharmacies' sales team and other RxLegacy team members to maintain momentum
- Utilizes sales team
- As needed, refers to outside resources

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Other Rx Legacy Team Members

- **AmerisourceBergen**
 - Charlie Le Bon
 - Bill LaRose
 - John Pross
 - Business coaches
- **Financial Advice/Lending**
 - First Financial Bank
 - Live Oak Bank

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Pharmacy for Sale! ... but how sellable?

Bill LaRose, R.Ph: Pharmacy Acquisition Advisor
Justin Baker: Business Coach
AmerisourceBergen

June 7, 2018



Speaker Disclosure

Bill LaRose, R.Ph and Justin Baker are employees of AmerisourceBergen and have no actual or potential conflict of interest in relation to this program / presentation.

Overview

- Review the independent pharmacy marketplace
- Discuss factors and strategies that influence pharmacy value in determining purchase price (i.e. increase the value of your pharmacy business)
- Explain the steps in the successful selling process
- Identify the process of determining “value”

Current Independent Pharmacy Marketplace



22,000+ independent pharmacies in the U.S.



Average annual sales per pharmacy: \$3.6 million; GM 22%



\$80 billion marketplace



92% of sales are prescription drugs (1.2 billion scripts)



Average annual script fills per pharmacy: 60,000 (192 per day)

Current Independent Pharmacy Marketplace



31% generate less than \$2.5 million in gross sales per year



13% generate more than \$6.5 million in gross sales per year





60% of owners are older than 55



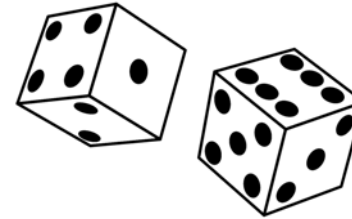
700-900 independent pharmacies change ownership per year

Three Potential Scenarios

Pharmacy A 	Pharmacy B 	Pharmacy C 
		

Key Takeaway: Don't Roll the Dice on Your Future!

Let's get started



Achieving Success

Part 1

Successful Selling








Part 2

Strategies to Increase Value



Successful Selling

A five-step process

-  Define the sale
-  Get your house in order
-  Valuation
-  Set the right price
-  Find a buyer

Step 1: Define the Sale

Why are you selling?



▪ One day...

ALL owners
WILL transition
out of there
business...

Define the Sale

Why are you selling?



Choice

Exit strategy
Retirement

Circumstance

Health issues/death
Declining business



Step 2: Get your house in order

How can you improve your financial & physical curb appeal?



- Create the Team
- Get Educated
- Improve record keeping
- Identify seller discretionary expenses (aka add backs)
- Increase business efficiencies
- Make improvements to the interior and exterior of your store
- Be prepared to answer...
- **Show your income!**



Step 3: Conduct a Valuation

What is your pharmacy worth?



- 3 years of profit and loss statements/balance sheets
- 3 years of tax returns
- Pharmacy prescription reports:
 - Top payers
 - Top drugs dispensed
 - Generic vs. brand, new vs. refill
 - Cost of goods (purchasing power)
 - Rebates
 - Ability to recast/normalize the financial statements accordingly for a new owner



Step 3: Conduct an “Opinion of Value”

What is your pharmacy worth?



- “Value” is actually an “opinion of value”
- Pharmacy is worth “what a willing and able buyer agrees to pay”
- and / or what a financial institution is willing to fund
- Multiple rules of thumb and guidelines used – with ranges
- ALL taken together to determine an opinion of value

Valuation (opinion of value) – Industry “Rules of Thumb”

What is your pharmacy worth – a peek behind the curtain



1. % of Gross Sales (18% - 22%)
2. 1-Year Gross Margin \$ (+ / - 1%)
3. Dollars per Annualized Scripts (\$10 - \$15 per annualized Script)
4. Multiple of Owner’s Discretionary Income (2.5 to 3.5 X Adjusted EDITDA)
5. ROI (generate a minimum of 10% cash on cash return on your up-front investment)

Opinion of Value

Example – 2017 Financials



- **TOTAL GROSS SALES** \$4,540,058
- COS - \$4,117,632
- - (Rebates Rx) \$(575,380)
- **TOTAL COST OF SALES** \$3,546,835
- **GROSS MARGIN \$** \$993,223
- Gross Margin % 21.9%
- **TOTAL OPERATING EXPENSES** \$859,960
- **NET INCOME** \$133,263
- **ADJUSTED EBITDA** \$350,426
- **Annual Scripts** 55,244
- **APPROXIMATE INVENTORY** \$325,000

Opinion of Value

Example – Rules of thumb



Gross Sales	\$ 4,540,058	Gross Margin	\$ 993,223	Annual Rx's Filled	55,244
Low Value		Low Value		Low Value	
18%	\$ 817,210	-1%	\$ 947,822	\$10.50	\$ 580,062
Medium Value		Medium Value		Medium value	
20%	\$ 908,012	0%	\$ 993,223	\$12.50	\$ 690,550
High Value		High Value		High Value	
22%	\$ 998,813	1%	\$ 1,038,624	\$14.50	\$ 801,038

Opinion of Value

Example – add backs and multiple of EBITDA



Add-backs	
Amortization	
Depreciation	
Interest	
Taxes (Property)	\$11,112
Owners Compensation	\$193,666
Owners Benefits	\$38,260
Other Payroll Adjust.	(\$44,100)
Management Fees	
Dues & Subscriptions	
Donations/Gifts	\$635
Bad Debts	\$2,941
Entertainment/Meals	\$572
Travel	\$1,206
Professional Fees	
Delivery/Auto	\$642
Ins. (building)	\$1,345
Repairs & Maint.	\$5,989
Equip Rental	\$382
SS offset / owner replacement	\$4,513
Misc. 5	
Misc. 6	
Misc. 7	
Total	\$217,163

Adjusted EBITDA	\$	350,426
Low Value		
2.5	\$	876,065
Medium value		
3	\$	1,051,278
High Value		
3.5	\$	1,226,491

Opinion of Value

Weighted Averages and determining realistic price



Weighted Average Value Method #1, #2, #3, #4

Low Value		
Method's #1,#2,#3,#4	\$	833,600
Medium Value		
Method's #1,#2,#3,#4	\$	950,397
High Value		
Method's #1,#2,#3,#4	\$	1,003,974

- Weighted averages for H-M-L
- Range would be \$830K - \$1.0M plus inventory (\$325K)
- Apply the following guidelines; Based on business trends for last 3 years for scripts & sales:
 - declining – closer to lower
 - relatively flat (+/- 2%) – closer middle
 - strong growth – closer to upper

Step 4: Set the Right Price

How do you know if your price is right?



- Realistic
- Fair and equitable
- Buyer needs to earn a living, pay expenses, cover debt service
- Justifiable

Summary: Successful Selling



Conduct a valuation



Define the sale



Clean house



Set the right price



Find a buyer

Achieving Success

Part 1

Successful
Stores

Part 2

Strategies to
Increase Value



Common Marketplace Challenges

EXTERNAL PRESSURES

DECLINING Rx VOLUME

- Adherence – get more Rx from existing patients
- DD Marketing/Prescriber Marketing – target specific providers and patients to use limited time and resources more effectively
- Employee Development – enable employees to increase sales and ensure an exceptional customer experience
- Retail Excellence – understand the role of the front end and how it can attract customers and add to the experience

DECLINING PROFITS

- Maximizing Reimbursement – make sure you aren't leaving money on the table
- DD Marketing – use data to target providers/products or payers with higher reimbursement; develop relationships that lead to referrals
- Retail Excellence – capitalize on higher profits from the front end
- Adherence – boost performance ratings for better reimbursement
- Financial Benchmarking – prevent financial baggage from causing cash flow issues; know the COD to ensure proper pricing strategy

INTERNAL PRESSURES

OPERATIONAL ISSUES

- Inventory – as one of the largest expenses, manage inventory properly to avoid cash flow or customer service issues
- Labor & Productivity – as the largest expense, monitor and adjust labor costs so they don't lead to problems with profitability and productivity
- Employee Development – train and deploy staff effectively and they can make a positive impact on every facet of a pharmacy's operations, ensuring customer satisfaction and overall pharmacy success

Valuation Case Study

Why this store?

Baker's Pharmacy – Small Market Pharmacy



All the best practices we'll touch on today apply to low/ medium/ high volume stores.



This particular example is \$1.3mm annually



These are the stores that without a plan, will be forced to sell files or shut down all together



This is the type of store that many of you very successful business owners in this room started at...worked hard, grew the business, and created your own LEGACY!

I'm calling my Business Coach and selling this place!

Store Owner-

"I need you to reach out to someone about selling my pharmacy. I have no idea what its worth...all I know is I'm short on my wholesale bill almost every two weeks and it's not looking good. I'd probably settle for \$500k and just walk away."



Business Coach -

"It sounds like you're frustrated. Let's do this...I'll be by the store next week to pick up all the annual financial documents and we can discuss it further."

Identifying Opportunities and Taking Action

Baker's Pharmacy – Financial View

"What's my pharmacy worth?"

Baker's Pharmacy 2016 Financial View

2016 Financial Information	
TOTAL GROSS SALES	\$ 1,349,551.00
TOTAL COST OF SALES	\$ 972,913.00
Cost of Sales %	\$ 0.72
GROSS MARGIN \$	\$ 376,638.00
Gross Margin %	\$ 0.28
TOTAL OPERATING EXPENSES	\$ 462,167.00
% of Revenue	\$ 0.34
NET INCOME	\$ (85,529.00)
% of Revenue	\$ (0.06)
ADJUSTED EBITDA	\$ 5,035.00
% of Revenue	\$ 0.00
APPROXIMATE INVENTORY	\$ 170,000.00

Opportunities

Payroll – 18.62% of sales*

- *The NCPA average in the region is 13.2%
- Tenured staff with set hours
- Staffing not aligned with workload
- *"This is the way we've always done it – it's comfortable"*



Coach suggestion:
eliminate ALL overtime

Opportunities

Inventory - \$170k, 6 turns*

- *NCPA average is 12 turns
- Not utilizing technology
- No awareness to process
- Sell one, order one
- “We never want to run out of anything!”



Coach suggestion:
Create awareness, change behavior and ordering habits

Opportunities





Hours of Operation – 60 hours/week*

- *43% of Pharmacies operate between 40-49 hours per week
- Prescriptions filled per hour: 7
- Hours: Monday – Saturday - 8am – 6pm
- “The other store in town is open...”



Coach suggestion:
Adjust store hours based on peer comparison and fill rate analysis

Results!

-  • Payroll - 14.47% (4.15% reduction)
-  • Inventory - \$100k, 10 turns (\$70k reduction, 4 turn incr.)
-  • Hours of operation
 - New hours: M-F: 8-6, Sat: 9-2 (5 hour reduction)
 - Prescriptions filled per hour - 9 (increase by 2/hour)
-  • Cost of Dispense - \$12.43 (\$0.63 reduction/script)
- Net income?

Baker's Pharmacy – 2017 Financial View

“What's my pharmacy worth NOW?”

Baker's Pharmacy 2017 Financial View

2017 Financial Information	
TOTAL GROSS SALES	\$ 1,262,302.00
TOTAL COST OF SALES	\$ 858,847.00
Cost of Sales %	\$ 0.68
GROSS MARGIN \$	\$ 403,455.00
Gross Margin %	\$ 0.32
TOTAL OPERATING EXPENSES	\$ 396,627.00
% of Revenue	\$ 0.31
NET INCOME	\$ 6,828.00
% of Revenue	\$ 0.01
ADJUSTED EBITDA	\$ 98,256.00
% of Revenue	\$ 0.08
APPROXIMATE INVENTORY	\$ 100,048.00

So do best practices pay off?

"Did all the hard work contribute to my exit strategy?"

Market Valuation

Opinion of Value
Baker's Pharmacy
(As of April 4th, 2017)

\$95k - \$115k

(Excludes inventory)



Market Valuation

Opinion of Value
Baker's Pharmacy
(As of April 4th, 2018)

\$260k - \$345

(Excludes inventory)

FINANCING PHARMACIES

Greco DeValencia | Loan Officer, Pharmacy Lending
Live Oak Bank

Disclosure Information

- I am a paid employee of Live Oak Bank



Why Banks Finance Pharmacies

- Deposits
- Credit cards
- Low default rates
- Opportunity
 - Average pharmacy acquisition project: \$1.6MM



SBA = Small Business Administration

Loan Performance 2010-2015

Industry	# Disb	\$ Disb (000's)	Failure %	Chrg Off%
Veterinarians	2,267	\$1,448,552,349	1.10%	0.16%
Dentists	5,175	\$2,451,055,136	1.02%	0.08%
Optometrists	990	\$283,847,424	1.72%	0.09%
Hotels/Motels	3,566	\$5,973,142,013	1.37%	0.04%
Funeral Homes	916	\$738,694,819	1.20%	0.02%
Phy/Speech Therp	1,132	\$250,858,543	1.50%	0.13%
Physicians	4,041	\$1,611,899,693	2.05%	0.16%
Pharmacies	1,830	\$1,026,271,763 <small>(average loan \$295,000)</small>	2.19%	0.04%
Lawyers	2,755	\$583,974,028	2.25%	0.35%
Engineers	1,365	\$493,320,956	2.71%	0.73%
All Industries	42,345	\$21,626,831,409	2.13%	0.12%

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Types of Short-Term Financing

Lines of Credit

Re-Apply Annually
Short-Term solution for the ebbs and flow of normal business cycles

Wholesaler Dating/ Inventory Buy-Ins

Dating on inventory purchases
Past-Due Balances converted to a note

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Types of Long Term Financing

Conventional Loans

Balloon Payments
Loan Covenants
Collateral Requirements (i.e. real estate)
1% - 2% Origination Fee

Small Business Administration (SBA) Loans

Full Amortization (No Balloon Payments)
No Loan Covenants
Collateral Is Not Part Of Decision To Lend
2.25% - 2.62% SBA Guaranty Fee

2 Types of SBA Loan Processing:

GP = General 7(a) Lender vs. PLP = Preferred Lending Partner

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Commonly Used Terms in Lending (Continued)

Same Loan Term & Amortization

- Term = 10yrs
- Amortization = 10yrs
- NO Balloon payment

Different Loan Term & Amortization

- Term = 5yrs
- Amortization = 10yrs
- 1-time Balloon payment (end of 5yrs)

The Five “C’s” of Pharmacy Lending

- Conditions
- Character (Competency)
- Capacity (Cash Flow)
- Collateral
- Capital (Cash)

Conditions



Credit



Capacity (Cash Flow)

Profit and Loss Statement	
Company Name	
For the Month of Year ending *Month-Over-Year*	
Month in Bill	Month in Bill
Gross Margin (\$12)	
Returns on sales (\$12)	
	Current Price
Sales Revenue	
Prescription	
Pharmacy Services	
Other Sales Revenue (\$0)	
	\$
Cost of Sales	
Prescription	
Pharmacy Services	
Other Cost of Sales (\$0)	
	\$
Gross Profit (\$12-0)	
	\$
Operating Expenses	
Salaries and Wages	
Rent	
Utilities	
Travel and Marketing Expenses (\$0)	
Other Operating Expenses	
	\$
Non-Operating Expenses	
Depreciation Expense	
Amortization Expense	
Other Non-Operating Expenses (\$0)	
	\$
Total Operating Expenses (\$0-0-0)	
	\$
Income from Operations (\$12-0)	
	\$
Other Income (\$0)	
	\$
Total Income	
Interest Income	
Dividend Income	
Other Income (\$0)	
	\$
Total Income (\$12-0-0)	
	\$

Collateral



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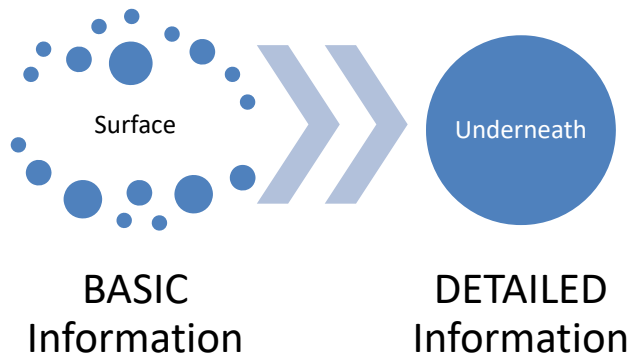
Capital (Cash)



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Importance of Due Diligence



Types of Acquisitions

Stock Purchase vs. Asset Purchase

STOCK PURCHASE

Buyer purchases the seller's corporation.

ASSET PURCHASE

Buyer purchases only the pharmacy assets. Two types of assets:

1. Tangible Assets
 - Inventory
 - Accounts Receivable
 - FFE (Furniture, Fixtures and Equipment)
 - Commercial Real Estate
2. Intangible Assets
 - Goodwill
 - Prescription Files

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Commonly Used Terms in Lending

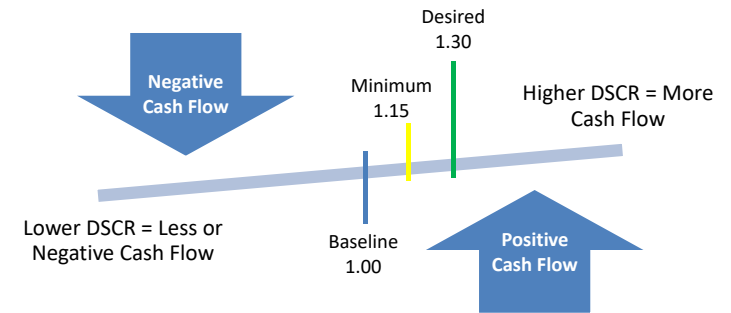
- “EBITDA” = Earnings Before Interest, Taxes, Depreciation, and Amortization
- “Add-backs” = Expenses that are added-back to cash flow to normalize a Profit and Loss statement
- “NOI” = Net Operating Income, often-called cash flow. Includes EBITDA + add-backs + owner’s compensation

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Commonly Used Terms in Lending (Continued)

“Debt Service Coverage Ratio (DSCR)” is the ratio of the cash available to service debt and the total debt service for all interest, principal, and lease payments.



Understanding the Income Statement (P&L)

Simple P&L

Revenue

- Cost of Goods Sold

= Gross Profit

-Total Expenses

= Net Profit / Loss



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Normalizing Profit

Simple P&L

Revenue: \$3,700,000

- COGs: \$2,850,000

Gross Profit: \$850,000 (23%)

-Total Expenses: \$660,000

Net Income: \$190,000

Expenses Include:

• Wages	\$480,000
• Rent	\$35,000
• Auto	\$14,000
• IRA	\$40,000
• Interest	\$5,000
• Legal	\$20,000
• Depreciation	\$5,000
• Amortization	\$0
• Other	\$61,000

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Simple P&L

Revenue:	\$3,700,000
- COGs:	\$2,850,000
Gross Profit:	\$850,000 (23%)
-Total Expenses:	\$660,000
Net Income:	\$190,000

Traditional Add-Backs

Interest	\$5,000
Depreciation	\$5,000
Amortization	\$0
EBITDA:	\$200,000

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Normalizing Profit

Simple P&L

Revenue:	\$3,700,000
- COGs:	\$2,850,000
Gross Profit:	\$850,000 (23%)
-Total Expenses:	\$660,000
Net Income:	\$190,000

Discretionary Add-Backs

Auto	\$10,000
IRA	\$40,000
Legal	\$15,000

Material EBITDA \$265,000

Traditional Add-Backs

Interest	\$5,000
Depreciation	\$5,000
Amortization	\$0
EBITDA:	\$200,000



NK

Determining Available Cash Flow

Net Operating Income (NOI)

- Simplistic measure of cash flow available for Owner's Compensation and Debt Service
- NOI will identify the amount of cash available in the business based on historical performance
- NOI may include:
 - Officer Compensation
 - One-Time Expenses
 - Interest
 - Amortization
 - Depreciation
 - Rent

NOI
is
different
from
EBITDA

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How Much Cash do I Need?

Combination of:



Generally, aim to have a minimum of 10% down



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Take a Logical Approach

Do's

- Understand the practice niche (how it differentiates from competition)
- Understand the practice cash flow
- Retain industry experts (CPA, lawyer, banker)
- Prepare for the unexpected
- Prepare a budget for the future to gauge your performance

Don'ts

- Limit yourself to what is there - look for potential
- Don't pay for potential
- Don't be impatient - make a business decision
- Don't assume negative trends are easily reversed or that positive trends will always continue

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Questions?

Our Panel of Presenters Will Now Take Your Questions

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You cannot receive CE credit if you do not submit a completed evaluation form.



Questions?



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