

Buying and selling independent pharmacies – what you need to know



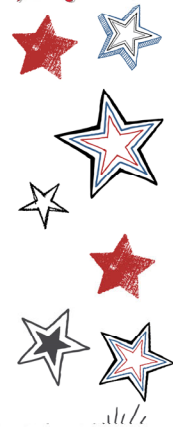
Presented by Directors of Pharmacy Acquisition:

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Disclosures

Roger White, Chad Sanders and Brett Fortier are employees and stock holders of Cardinal Health. The conflict of interest has been resolved by peer-review of the slide content.

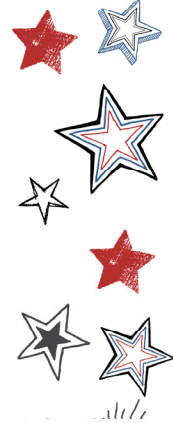


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Learning Objectives

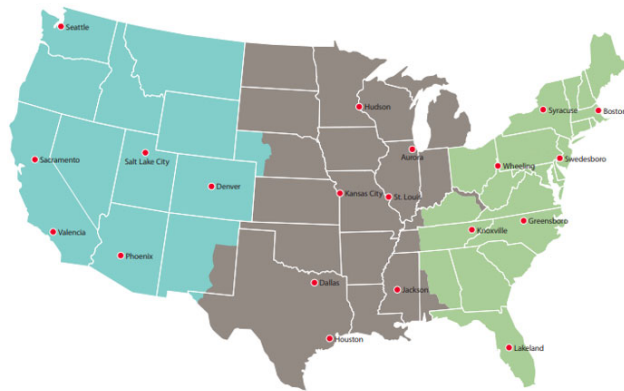
- Discuss key steps and roles played in the pharmacy buy/sell process.
- Outline key performance metrics and market factors that translate to a pharmacy valuation.
- Describe financing opportunities and structuring deals to maximize resources available.



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Pharmacy Transition Services



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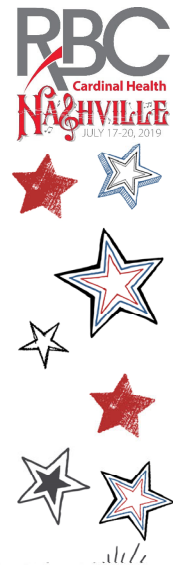
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Pharmacy Transition Services

- 53 combined years pharmacy industry experience
- 15 combined years transitioning pharmacy ownership
- More than 800 pharmacies transitioned
- More than 2,500 pharmacy valuations performed



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Presentation Overview

- Community pharmacy today
- Buying & selling landscape
- Seller & buyer planning
- Transition process overview
- Transition timeframe
- Pharmacy valuations
- Financing & purchasing structure
- Conclusion & questions



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Community Pharmacy Today



- 21,909 Pharmacies
- *Approx. 1,000 will change hands each year*
- \$3.45 Million annual revenue
- 59,137 Annual Rx
- 85% Generic
- 21.8% Gross profit (lowest in 10yrs)
- Avg owner > 62 years
- **2.0 – Avg. number of pharmacies per owner**



Source: 2018 NCPA Digest



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What does a valuable pharmacy look like?



ATTRACTIVE

- > \$3MM revenue
- Favorable profitability
- Lean operational expenses
- Staffing & labor
- Stable or growth trend
- Reasonable rent & lease
- Differentiation
- Location
- Competition

CHALLENGES

- < \$2.0 Million revenue
- Unclear and/or outdated financials
- Underperformance
- Overstaffed / extended hours
- Declining rev / Rx
- Excessive rent
- Unfavorable lease terms
- "Premium" ask price
- Limited growth potential



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What is the Pharmacy Worth?



1. What a **SELLER** is willing to sell it for
2. What a **BUYER** is willing to pay for it
3. What a **LENDER** is willing to invest in it

ALL 3 MUST BE ALIGNED



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Selling to the Chains



- Pharmacist
- Local pharmacy owner
- Investment buyer
- Chains may not include value of
 - Deliveries, compounds, care homes, etc.
 - Automation, fixtures, computers, etc.
 - Front store sales
 - DME/HME sales
 - Low demand Rx products
 - Real estate



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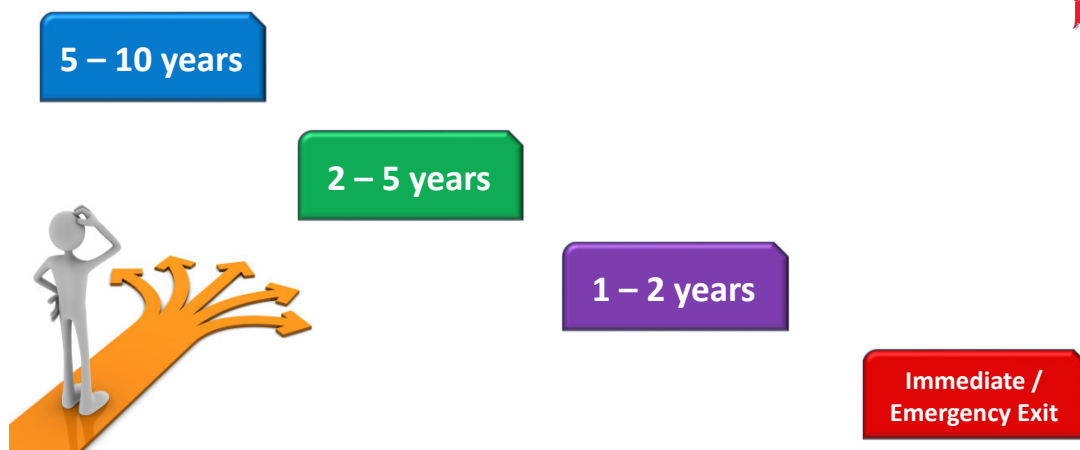
Selling to the Chains



- Buyout may be quicker but residual demands can extend the completion:
 - Seller and/or staff employment tied to retention clause
 - Collecting final A/R
 - Selling OTC and other inventory
 - Liquidating FFE
 - Real estate (lease/sell)

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Sellers – When Is the Right Time?



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Seller Planning



- Do you have a succession plan established?
 - *Who will buy the pharmacy?*
- Can you demonstrate minimum two years of profitability?
- Do you have a team to assist with the transition?
 - *Attorney, CPA, Business Partner(s), Wholesale Partner, Financial Planner, Etc.*
- Is retirement entirely dependent on the proceeds of the sale?
- Have you considered the tax implications?
- How will this impact the employees and community?

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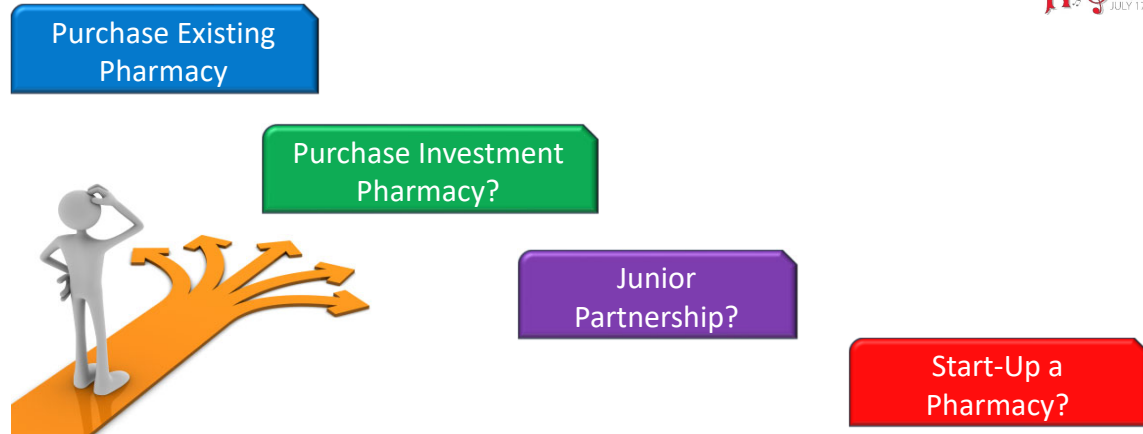
Seller Planning



- Are you educated on:
 - The market value of your business
 - Decision criteria for lending approval
 - How financing is structured
- Be prepared to answer:
 - Do you want to carry a seller promissory note?
 - Do you want to continue working in this pharmacy?
 - Do you want to rent/sell your building? (if applicable)

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Buyer Planning – What Is the Path to Ownership?



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Junior Partnerships



- Why create a Jr. Partnership when financing is readily available?
- Can be a solution for owner's looking to expand into multiple locations
- Can be very risky and should have very specific details included in the agreement
 - Always consult with an attorney
 - Is there a way to separate the partnership?

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Start Up Pharmacy

- Location
 - Demographics
 - Competition
 - Traffic patterns and visibility
 - How many/what kind of scripts are filled in this area?
 - What is your competitive advantage?
- Capital
 - Business plan and financial projections
 - Access to adequate working capital for 12-18 months
 - How quickly can you break-even?
 - Willingness to work for less than market rates



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Buyer Planning

- Where are you willing to acquire?
- Target pharmacy requirements?
 - Size
 - Staffing
 - Niche markets and services
- Who is on your team?
 - Attorney, CPA, Wholesale Partner, Business Partner



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Buying Process

- Identify the right pharmacy
- Understand the opportunity
 - Pharmacy due diligence
 - Valuation
 - Trends
- Negotiate in good faith
 - Term sheet/LOI
 - Real estate involved
 - Seller carry, bank, friends and family, supplier, combination thereof...

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Do's and Don'ts of an Acquisition

Do's

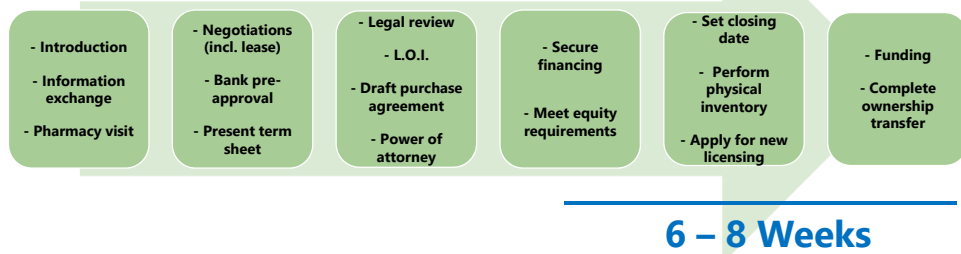
- Understand the business and its differentiators
- Understand the current cash flow opportunity
- Retain industry experts (CPA, lawyer, bank)
- **Be prepared for the unexpected**
- Prepare a budget and forecast future performance

Don'ts

- Limit yourself to what is there, instead look for potential
- **Don't pay for potential**
- Let emotions outweigh a business decision
- Assume negative trends are easily reversed or that positive trends will always continue
- Don't get into a bidding war

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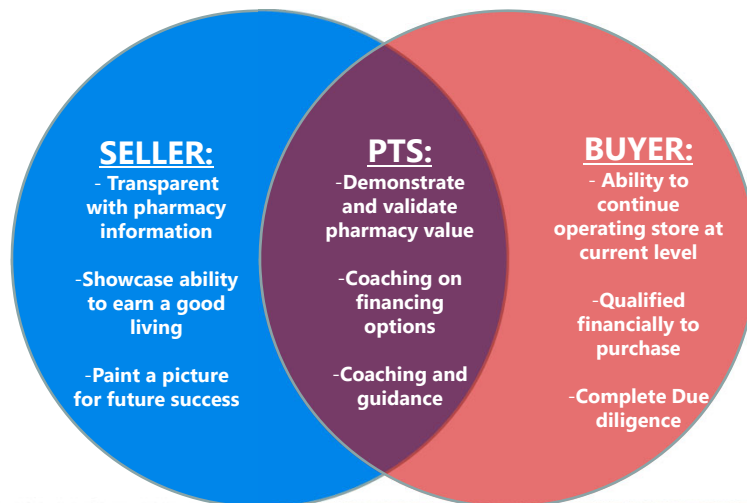
Transition Timeline



2 - 12 Months

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Roles



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Financing

- Selecting a lender
- Lender qualifications
- Business plan & financial projections
- Cash down payment (un-borrowed)
- Working capital needs
- Financing structures (asset vs. stock)

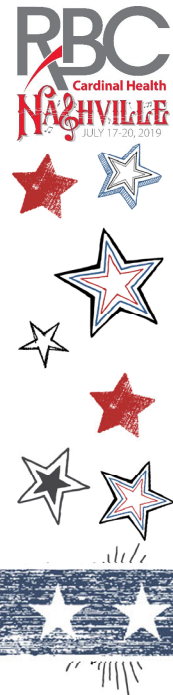


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To Support a Loan the Pharmacy Must...

- Enable the buyer to earn market compensation
- Allow for debt repayment on the total project cost -- debt coverage of 1.4 or higher
- Appraise....

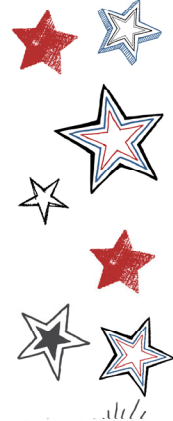


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Performing a Pharmacy Valuation

- Financials
 - 3 years federal tax returns
 - Year-to-date P&L and B/S
 - Re-cast earnings / normalize
- Pharmacy Reports
 - Gross margin summary logs
 - 3rd party plans, % Medicaid
 - Product mix
 - Controls & cash %

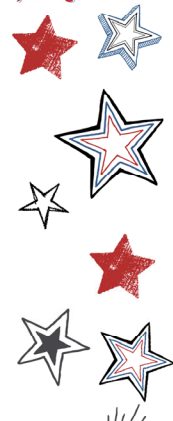


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Pharmacy Goodwill Valuations

1. Annual prescription volume
 - Chain method/ file buys
 - Wide range (\$6-\$14 per Rx)
2. Annual revenue
 - Typically 15 – 20%
3. Multiple of EBITDA
 - 2.5 to 3.5 x

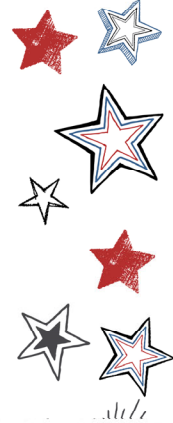


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Typical Purchase Structure

- Asset vs. Stock
 - Asset is most common
- 75-90% bank loan
 - SBA Lender (total project cost)
 - Wholesaler
 - Local community bank
- 10-25% equity requirement, combo of:
 - Buyer cash down payment
 - Seller promissory note
- Buyer will need working capital
 - Cash (Savings, 401K, Family)
 - Added to loan (total project cost)
 - Inventory dating from Wholesaler

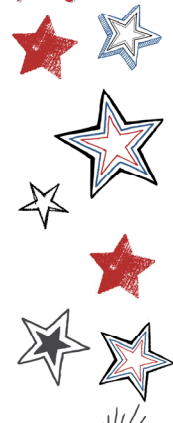


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Pharmacy Valuation (Example)

- \$3,200,000 Total revenue
 - 55,000 Annual Rx
 - Normalized EBITDA - \$175,000
 - \$40,000 (2015 Tax return earnings)
 - \$35,000 (Depreciation & amortization)
 - \$75,000 (Officer comp)
 - \$10,000 (Delivery vehicle = Mercedes)
 - \$15,000 (Pension & personal misc)
1. $\$175,000 \times 3 = \$525,000 + \text{Inventory}$
 2. $\$3,200,000 \times 20\% = \$576,000 + \text{Inventory}$
 3. $55,000 \times \$12 \text{ script} = \$660,000 + \text{Inventory}$

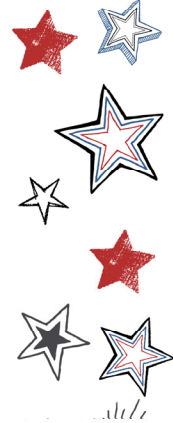


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Pharmacy Acquisition Loan Example A

- Budget = \$870,000
 - \$500,000 = Goodwill
 - \$200,000 = Inventory
 - \$150,000 = Working capital
 - \$20,000 = Closing costs (if SBA financing)
- Funding Sources
 - \$90,000 = Buyer down payment
 - \$0 = Seller Note
 - \$780,000 = Bank note

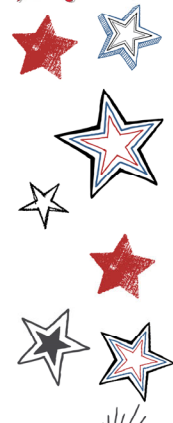


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Pharmacy Acquisition Loan Example B

- Budget = \$1,020,000
 - \$600,000 = Goodwill (increased \$100k)
 - \$250,000 = Inventory (increased \$50k)
 - \$150,000 = Working capital
 - \$20,000 = Closing costs (if SBA financing)
- Funding Sources
 - \$102,000 = Buyer down payment (Increased \$12k)
 - \$0 = Seller Note
 - \$918,000 = Bank note (increased \$138k)

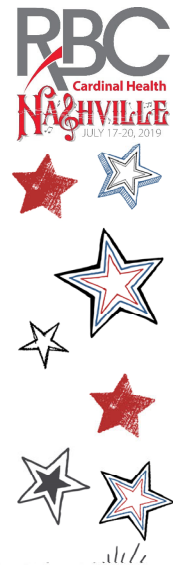


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Servicing Debt

- Example A: \$500,000 GW + \$200,000 Inv
 - \$111,000 annual payment
 - \$175,000 annual EBITDA
 - 1.57 DSCR
- Example B: \$600,000 GW + \$250,000 Inv
 - \$130,750 annual payment
 - \$175,000 annual EBITDA
 - 1.33 DSCR



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Professional Assistance With...

- Financial score carding and fitness
- Create your strategic transition plan
 - Buying or selling
- Pharmacy valuation
- Marketing your pharmacy for sale
- Locating pharmacies to buy
- Financing and deal structure
- Alliance with legal experts and financial planners
- **Don't Pay Broker Fees**



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Questions?



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