

BUYING A PHARMACY

Buying and managing their own pharmacy business is something that recently qualified pharmacists sometimes aspire to, but knowing where to start is often a problem. This feature looks at the practical, financial and legal aspects of buying a pharmacy business

A GUIDE FOR THE FIRST-TIME BUYER

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Although there is risk inherent in buying a pharmacy, this can be minimised by taking appropriate advice and doing plenty of research and homework before making a final decision on what to buy.

It is likely that this will be the largest and most complicated transaction in which a prospective purchaser will ever have been involved, so choosing one's advisers carefully is essential.

Plenty of good advice is available at all stages of the transaction - especially in connection with finding and financing the business and completing the legal formalities.

While finding and financing are separate operations, the choice of business is clearly restricted by the availability of funds, so it is important to know at an early stage how much capital is available and how much loan, or other finance, can be raised.

SALES AGENCY

A first-time buyer would be well advised at this stage to make contact with an established and reputable specialist pharmacy sales agency. A quick look at the classified advertisement section of The Pharmaceutical Journal will identify a selection of agents of all sizes and in various locations. Pick ones that cover the geographical area in which you are interested (some operate nationally) and phone them for a chat. It is important that they have a local knowledge of your particular area and that you feel you can strike up a good working relationship with them. Some vendors restrict their agent from advertising their pharmacy details, so the only way you will obtain information about these businesses is to speak to the agent.

The number of pharmacies that agents can advertise is limited by the size of their adverts, so browse through the web sites where you will find brief details of all of the businesses they have to sell, with the exception of those where advertising is

restricted by the vendor. The Orridge website www.pharmacysales.net has, on average, details of about 100 pharmacies currently on the market.

The agent will be able to advise you of potential sources of finance and how much you are likely to be able to borrow. As a rule of thumb, clearing banks will probably lend in the region of 80 per cent of the true value of a business and possibly also the value of the stock, provided you have security. Security can take the form of mortgageable assets, including any freehold property you acquire with the business, but nowadays about 90 per cent of first-time buyers use a wholesaler to act as guarantor under one of their loan guarantee schemes.

These schemes are offered by the major wholesalers but do not forget to talk to the local independent wholesalers as well, as they may be just as keen to do business with you. Your agent will be able to tell you which schemes are on offer and which banks are currently keen to lend. Alternatively another look at the classified section of The Journal may be helpful.

No matter from whom you will be borrowing, a proper presentation of your business plan will make your task much easier. You will need details of the past performance of the business (which should be available from the vendor's agent), together with profit and cash flow forecasts. If you have no experience in producing these, consider employing an accountant that has; money well spent here will give your case a much better chance of success.



Buying a pharmacy will be the largest and most complicated transaction in which a prospective purchaser will ever have been involved

TRUE VALUE

The true value of a business was referred to above. The best definition of the true value of any business is what it will fetch on the open market, but in the context of obtaining finance it means the value according to an accepted formula within the pharmacy profession. Different agents and finance houses have different ways of arriving at this figure, which is linked to the return on investment, but they invariably end up very close to each other's valuations. The significance of this figure is that while you may put a premium value on working in a Cornish fishing village, the banks will probably not and will consequently lend a percentage of the true value, not your perceived value. Your agent should be pleased to explain the basic principles of pharmacy valuation. You may be tempted to buy one of the pharmacies offered for sale privately or by an agent whose client has insisted on offering his business at an inflated price. If you are in doubt, a reputable agent will value a private business for you for a modest fee and could save you several thousands of pounds and a lot of wasted time.

TURNOVER

Having arrived at your budget figure the next decision is what to buy. Assuming you have chosen your rough geographical area, you will need to consider the various types of business on offer.

In recent years, larger businesses have become available to first time buyers due to the support offered by wholesalers. These businesses are often easier to finance than smaller ones and it is not unknown for businesses with turnover in excess of £500,000 to be acquired by a first time buyer.

Multiples and regional groups with between 2 and 40 shops, rarely look at businesses with turnovers of less than £700,000 and the larger the turnover, the greater the competition and the more likely for a premium price to be achieved. Except in special circumstances, few pharmacies sell, with a turnover below £300,000 although at Orridge we do occasionally manage to find a buyer. This leaves a band of turnover between £300,000 and £600,000 available to first and second time buyers.

Several types of pharmacy fall within this group with plenty of choice of urban and suburban locations. The best of these are usually close to a doctor's surgery and also have a thriving over-the-counter trade. Those in suburbia are usually less attractive to multiples due to their secondary positions and therefore offer good value opportunities to independents. Also in this group will fall pharmacies adjacent to or within a health centre. These are normally very attractive to purchasers as they will dispense upwards of 5,000 prescription items per month and are often sold to those with one or two local pharmacies or, if large enough, to multiples.

DISPENSING

The relationship between dispensing and OTC turnover is an important one to understand as it not only determines the profit margins that the business will make but, particularly with small businesses, has a bearing on its future security. With the exception of essential small pharmacies (ESPs), those pharmacies with a turnover of less than about £300,000 (or even as much as £350,000 in some cases) are potentially unsaleable unless they can obtain consent for a relocation or a competitor is prepared to buy the business and close it down.

In order to qualify as an ESP, a pharmacy must be at least one kilometre from the nearest pharmacy with a National Health Service contract, so they tend to be in rural locations or residential areas. They must also have a low level of dispensing. A pharmacy which qualifies for an ESP allowance will receive an additional payment over and above its other NHS remuneration and will therefore achieve a considerably higher gross margin on dispensing turnover. ESPs have not been very popular with purchasers, but they should definitely be considered by first-time buyers on the grounds that they tend to be cheap to buy, offer a secure, if not enormous, NHS income, are capable of providing a good overall income and are frequently situated in pleasant surroundings.

PROFIT MARGINS

To understand the different profit margins you will encounter during your search, it is essential to consider the turnover split. On dispensing you can expect to make a gross margin of between 18% and 22%, whereas OTC sales will give you in the region of 30% to 35%, so a good mix will provide a sensible margin and the security of NHS dispensing.

Do not automatically be put off a business which appears to be under-performing. There are exceptions to every rule and it may be that a poorly performing business is simply not being competitive. A prospective purchaser should consider whether the shop could benefit from longer opening hours. It could be possible to stay open while the doctor's surgery remains open or to stay open at lunch time. There may be potential to obtain additional dispensing from nursing homes, or by offering a collection and delivery service. By re-organising or refitting the premises it might be possible to attract more OTC sales.

PROPERTY

When you have found your ideal pharmacy there is a lot of research necessary before you reach the offer stage and here you may need to consult professional advisers. If the premises are leasehold, ensure that the lease offers enough security of tenure to satisfy your financier. Ascertain when the rent reviews take

place and if a review is imminent try to find out, by talking to neighbouring shop owners and local estate agents, what the new rent is likely to be. If there are clauses in the lease with onerous repairing covenants you would be well advised to have a professional condition survey carried out to ensure you are not taking on any unforeseen liabilities. Your solicitor should warn you about all of these potential problems but, in practice, you may need to prompt him.

You will probably be taking an assignment of a lease and will therefore need references for the landlord. As you are unlikely to have a track record with suppliers, you will have to rely on a bank reference and possibly character references, so strike up a good relationship with your bank as soon you can.

CHANGING CIRCUMSTANCES & THE AFFECT OF THE OFT REPORT

One of the biggest potential problems you could face is changing circumstances that would affect future trading. As the Office of Fair Trading has made us all too aware, nothing is guaranteed for ever. Whilst the first three months of 2003 have probably been the most uncertain I have known in my 35 years at Orridge, it is interesting to look at the statistics for that period and compare them with 2002 and prior years, remembering that in 2002 we were all aware of the impending OFT report. From a total of 100 sales effected by Orridge Business Sales Ltd in 2002 and so far in 2003, prices seem to be holding up remarkably well. The multiple of *true* profit has, as expected, dropped slightly in the last quarter of 2002 and the first quarter of 2003 but conversely, price as a percentage of turnover has increased slightly. The main reason for these changes appears to be because *true* profits have increased over the period. Whilst 100 businesses is a small sample, taken as a percentage of all trading pharmacies, it is nevertheless a very significant percentage of those which changed hands during the period. The trend we found particularly interesting is that after a small drop in the number of pharmacies being sold over the whole period, compared with previous years, the number of sales currently in solicitors' hands and due to complete in the second quarter of 2003 is the highest of the last six quarters. Indeed, if there is any shortage of activity, it is becoming apparent that it is due to the shortage of new businesses coming on the market and not, as might be expected, due to the lack of buyers wishing to commit to acquisitions.

OFFER AND LEGAL PROCESS

Your solicitor will perform the local searches after your offer is accepted but ask the vendor if he is aware of anything that might affect the future trading of the business, such as relocation of another pharmacy, a new or moving health centre or doctor's surgery.

Assess your staffing requirements for when you have acquired the business, being aware that under the provisions of TUPE, you will be taking over the existing employees, complete with all of their employment rights, including redundancy pay, sick pay, holiday pay, notice rights, etc. Do not underestimate the potential liabilities you will inherit. If you are unfamiliar with employment legislation, you will be well advised to consult a specialist employment lawyer.

When you are ready, make your offer (subject to contract) through the agent acting for the vendor. Try to ascertain how much interest in the business there is, to help you pitch your offer at the correct level. It may be possible to secure the business for less than the asking price, but if there is plenty of interest it may be necessary to offer 10 per cent or more above the advertised price.

Once your offer is accepted you may be asked to lodge a returnable deposit with the vendor's solicitor, which he will hold as stakeholder acting between the parties. While this is not compulsory it shows good faith on your part, which could help to fend off any late offers in excess of yours.

In order to progress the completion as swiftly as possible after receiving acceptance of your offer, you will need to have chosen a solicitor to act on your behalf. Choose carefully, ensuring that you find one with experience of commercial transactions and preferably conversant with the sale and purchase of pharmacies. This will ensure you get relevant advice and will probably save you money on legal fees. Your agent should know of several that have dealt with previous sales and purchases in an efficient manner and the right choice will help ensure a fast and smooth transaction. In recent years it has become commonplace for the purchaser's solicitor to set the ball rolling by drafting the sale and purchase agreement.

When both parties have agreed the contract terms, exchange of contracts is usually followed immediately by simultaneous completion. Apart from the usual chores of notifying the utility companies and dealing with VAT registration, you must give proper notice to the Royal Pharmaceutical Society and the local health authority. Here again the vendor's agent will be pleased to advise you on the procedures.

STOCKTAKING

Book a reputable firm of stocktakers to act for you in the transfer stock valuation and go thoroughly through their documentation, which should explain precisely the method they will adopt. Well before the stocktake date, take a detailed look at all of the stock in the shop and bring to the attention of the vendor areas where you are concerned, for example, overstocking of products you would not expect to sell quickly. Reach an agreement over the treatment of such items and ensure that the stocktaker in charge is notified on the day. Finally, make sure you are present during the stocktake so that you can agree with the vendor how to treat any problem stock, which the stocktakers identify.

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