



2017 to see largest number of pharmacy transactions in a decade

Understandably, there were very few sales and purchases of pharmacies during the recession, from 2008 up to 2014, apart from some distressed sales. The number of transactions started to increase slowly throughout 2015 and into 2016, and this year should see the largest number of pharmacy transactions since 2008.

Pharmacies are coming onto the market, creating an opportunity to buy your own pharmacy and get on the pharmacy ladder. The surge in transactions is explained by the pent-up demand from the low number of shops changing hands over the last few years.

Sellers have decided to sell for a number of reasons including:

- Age profile;
- Active market;
- Banks are lending to potential purchasers;



- Lifestyle decisions;
- Increase in valuation multiples;
- HSE reductions in pricing being largely over, e.g. FEMPI; and
- Shortage of qualified community pharmacists.

Professional Advisors

Before you engage in any transaction, you must have the correct professional advisors in place.

The first key advisor to have in place is your corporate finance advisor, who specialises in the community pharmacy sector. They will carry out a valuation in relation to the pharmacy, assess affordability based on your circumstances, and prepare financial projections and a business plan in order to secure bank and wholesaler funding. They will also carry out due diligence on the target and will guide you through the overall process up to the date of contract closing.

The second key advisor to have in place is a commercial lawyer with experience in community pharmacy transactions.

Valuation/Price Payable

The valuation/price payable for a pharmacy is one of the most critical issues to evaluate and consider. The agreed contract price needs to be a

win/win for both the vendor and purchaser. The vendor needs to feel that they have achieved a good price for their life's work and the purchaser must feel that they have scope to grow and improve the profitability of the pharmacy business under their future ownership.

The total price payable includes the combined value of goodwill, plus or minus net assets, plus the value of freehold property (if applicable). The goodwill of pharmacies is valued on a multiple of maintainable EBITDA (earnings before interest, tax, depreciation and amortisation). This valuation method is now the most common way to value a pharmacy. It gives the most accurate reflection of projected cash flow for the business.

In order to calculate the maintainable EBITDA of a pharmacy, you must estimate what you think the future EBITDA of the business will be. Factors that need to be taken into account include the impact of reference pricing on turnover, gross margin, other sales trends, sustainability of current overheads and adjustment for any excess salary or rent payments to directors. Other factors to be taken into account could include the likes of the opening of another pharmacy or the opening of a new primary care centre in the locality.

After adjusting for all of the above items, you will derive a maintainable EBITDA figure. It is this maintainable EBITDA figure which is then subject to a multiple in order to arrive at a valuation for the goodwill of your pharmacy.

Multiple

The average multiple being applied to maintainable EBITDA is currently five to six times. There are numerous factors that you need to consider when assessing the valuation multiple including:

- Turnover level (number of scripts, growth rates etc.);
- Sales mix;
- Gross margin;
- Wage costs;
- Rent and other overheads;
- Future growth potential;
- Impact of reference pricing;
- Future profits and cash generation from the business;
- Competition, including potential new openings;
- Proximity to GPs' surgeries;
- Nursing home accounts; and
- The establishment of a primary care centre in the locality.

There is no magic formula for calculating the earnings multiple but all of the above factors should be considered in assessing the valuation of a pharmacy.

Net Assets

In addition to the goodwill of a pharmacy business, you must also calculate the net asset valuation. The net asset valuation can be plus or minus depending on the balance sheet of the pharmacy business. The net asset valuation consists of the tangible assets associated with the business such as stock, debtors and cash at bank less all trading liabilities of the company.

Freehold Property

When there is a freehold property involved (property assumed to be included in the limited company), it is normal practice to have the property independently valued by a reputable firm of estate agents. The valuation of the freehold property would also be in addition to the pharmacy goodwill and net asset value.

Pre-Contract Due Diligence

When a contract price is agreed and heads of agreement (the basic main terms of the contract) have been signed, you then need to conduct thorough pre-contract due diligence on the company (the shop or shops)

"The valuation/price payable for a pharmacy is one of the most critical issues to evaluate and consider."



that you are buying. Due diligence consists of three main elements: financial, tax and legal.

- **Financial Due Diligence**
This process involves verifying the trading figures as per the vendors financial statements to the source records of the company. For example, to verify turnover you would reconcile the GMS/DPS/Private Scripts back to the pharmacy dispensing reports and through to the bank account.
- **Tax Due Diligence**
This involves verifying the workings of all tax liabilities. For example, checking the VAT, PAYE/PRSI and corporation tax workings.
- **Legal Due Diligence**
This is carried out by your commercial lawyer and will cover all legal aspects of the transaction. For example, ensuring employee contracts are in place and are in order, review of property lease, checking GMS license, insurance claims etc.

Bank and Wholesaler Funding

The banks are lending again to the community pharmacy sector but at a greatly reduced level compared to pre-2008. Typically, banks today will lend up to 75% of the purchase price of a shop. This leaves an equity gap of circa

30% (which includes stamp duty, professional fees and other costs). To put this in context, on a purchase price of €1 million plus all costs/fees, this would leave an equity requirement of €300,000, which is substantial. Please see the example below.

	€
Purchase Price	1,000,000
Stamp Duty @ 1%	10,000
Professional Fees & Costs	40,000
Total Outlay	1,050,000
Funded by	
Bank Funding @ 75% of Purchase Price	750,000
Promoters Equity Requirement	300,000
Total Funding	1,050,000

The wholesalers may bridge some of this equity gap with a short-term loan but this is hard on the cash flow of the pharmacy as it has to be repaid within the initial 36/42 months of the acquisition.

Other matters to note regarding bank funding are set out below.

- Personal guarantees will typically be required by all of the banks. The amount of the guarantee is a matter for negotiation but typically will be 25%/50%+ of the loan amount.

- Bank interest rate margins – Typically the average bank margin is 3%/3.5%+ plus the banks' cost of funds/base rate which might equate to a total interest rate of circa 4%+.
- Term of bank loan – Typically these are between 10/12 years from date of drawdown and are on a full capital and interest basis.
- Bank covenants – These are a matter for negotiation but may include a restriction on the level of directors' fees, submission of management accounts/year-end accounts, debt service ratios/EBITDA levels etc.
- Arrangement Fee – There may be some element of a bank arrangement fee payable, which should be negotiated.

Equity Gap

If you are a first-time buyer looking to purchase a pharmacy but do not have sufficient funds/equity, there may be an opportunity to secure some private funding from other pharmacists who are looking for investment opportunities. We have been involved in a number of these transactions over the last year. If you are interested in exploring this option, do not hesitate to contact me.

Summary

It is a good time to be buying pharmacies and this year will see a lot of opportunities arising across the country. Banks are lending again, although at a lower level, and the wholesalers are still very supportive of community pharmacies. Ensure you engage the right professional advisors.

It is now time for you to make a plan and to start making those phone calls to get the ball rolling and make it happen.

Jason Bradshaw is Partner of Corporate Finance with JPA Brenson Lawlor, Chartered Accountants and Business Advisors. Jason specialises in providing advice on business development plans, valuations, sale and purchase of pharmacies etc. to the community pharmacy sector. You can contact Jason at jason@brensonlawlor.ie or 01 668 9760.