Ever wondered whether owning your own pharmacy is worth it?

What with the credit crunch, category M reductions and the rise of the multiples, pharmacists might wonder if pharmacy ownership is still profitable for first-timers. Gareth Malson finds out how fruitful ownership can be.

If you find yourself giving the jobs section of The Pharmaceutical Journal a cursory glance, you might stumble upon a few adverts for pharmacies that are up for sale. Or you might have seen the following ad while browsing the “Business insight” section of PJ Online: “T/O £715,000. Approx 5,400 items pm. Offers over £500,000 for GW/Fix.” To established pharmacy business owners, this probably makes perfect sense. To those who are not, it might as well be written in Swahili.

The ins and outs of pharmacy finances are not taught as part of the pharmacy undergraduate course. As a result, many pharmacists remain oblivious to the earning potential of pharmacy ownership. If you are one of those pharmacists who has always been interested in owning your own business but never done anything about it (perhaps because you heard that making money from pharmacy was “much more difficult these days”) then read on.

Potential profits

The million-dollar question is: can first-time pharmacy owners still make a profit? Tony Townsend, national business sales manager for Orridge Business Sales Ltd, is adamant that they can. “Almost any pharmacy can be profitable if purchased for the right price,” he says. “Often, businesses — especially small ones — are run inefficiently before they are sold and an energetic new owner can increase profitability by bringing new ideas and making processes more efficient.” Although he admits that making a profit from pharmacy has become more difficult in recent years, particularly due to clawbacks in Category M reimbursement, Mr Townsend believes the profits are there if you find the right pharmacy at the right price.

“The million-dollar question is: can first-time pharmacy owners still make a profit?”
Easier said than done. So how does he suggest potential pharmacy owners go about it?

“It’s about research and flexibility,” he says. “Research into finance, the market, purchase costs and ongoing costs, and learn how to write business plans. Most of this information can be gleaned from professional advisers — namely accountants, solicitors or transfer agents.

“Flexibility with regards to the area you wish to buy can be advantageous. Many first-time buyers expect to be able to buy a pharmacy on their doorstep, but they might have to wait years for such an opportunity. The most successful buyers understand the restriction this attitude has on becoming an owner.” Some pharmacists are willing to commute two hours each way to their business, he says.

“Most importantly, look for a business where you believe you can add value,” Mr Townsend advises. This could be through improving the premises or the marketing of the business, securing contracts for work from organisations such as nursing homes, or working longer hours to coincide with local GP practices. A run-down business can be a great investment.”

Obtaining credit
Since the credit crunch began, small business owners have not been shy in pointing out the lack of funding available to them from the banks. However, Mr Townsend believes that pharmacy has been affected to a lesser extent than other types of business.

“Before the recession, many banks would offer loans to first-time business owners purely on the basis that they could provide 20% of the loan as equity,” he explains. “Now, the banks are looking at affordability; if a potential owner is going to be better off — in terms of income — after purchasing a business then, generally, banks are keen to support them. Generally, most banks require a deposit of around 25% for a business loan for a first-time buyer. This can fall to below 10% for established business owners.”

Typically, business loans are paid off over seven to 10 years. However, as reported in the March issue of *PJ Business Knowledge* Tony Townsend, national business sales manager for Orridge Business Sales Ltd, explains the fundamental principles of pharmacy finance.

### The basics of pharmacy business

<table>
<thead>
<tr>
<th>Topic</th>
<th>Details</th>
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</thead>
<tbody>
<tr>
<td>What does gross profit refer to?</td>
<td>Traditionally, gross profit refers to turnover minus the cost of goods (i.e., before the deduction of other costs, such as rent or salaries) — this is the way Orridge calculates gross profit. Some accountants deduct staff wages before calculating gross profit. Anyone comparing businesses advertised through more than one agent is advised to check which method is used to know whether the figures printed are comparable.</td>
</tr>
<tr>
<td>What other costs must be deducted before you can determine net profit?</td>
<td>All business overheads must be deducted. These include staff salaries (including pharmacists’ wage and locum fees), insurance, rent and business rates, electricity and heating bills, travel costs, telephone, postage, stationery, plus any other relevant overheads.</td>
</tr>
<tr>
<td>Is net profit your “salary” or are there more things to consider (e.g., investment)?</td>
<td>Net profit is what is left after the cost of all overheads has been deducted, however it does not include the repayment of any loans used (for example, to buy the business). If the owner is also the pharmacist, he or she will, in theory, have been paid a salary before net profit is calculated. Owners can do whatever they choose with the net profit after loan repayments have been made. This can include leaving the cash in the business “for a rainy day”, investing it to develop the business or paying themselves additional income.</td>
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</tbody>
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Offering services, such as medicines use reviews, could add as much as £40,000 to a pharmacy’s bottom line

“Most banks require a deposit of around 25% for a business loan for a first-time buyer”
Examples of profits that can be generated

Below are three examples of pharmacies sold by Orridge this year:

<table>
<thead>
<tr>
<th>Turnover</th>
<th>Gross profit</th>
<th>GP as %</th>
<th>Net profit</th>
<th>NP as %</th>
<th>Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>£380,000</td>
<td>£130,000</td>
<td>34%</td>
<td>£33,000</td>
<td>9%</td>
<td>2,800</td>
</tr>
<tr>
<td>£668,000</td>
<td>£225,000</td>
<td>34%</td>
<td>£44,000</td>
<td>7%</td>
<td>3,500</td>
</tr>
<tr>
<td>£950,000</td>
<td>£297,000</td>
<td>31%</td>
<td>£77,000</td>
<td>8%</td>
<td>6,000</td>
</tr>
</tbody>
</table>

Net profit is calculated after the pharmacist’s wage (and fees for occasional locum cover) have been deducted. However, loan repayments will need to be paid out of the net profit.

What is goodwill?

Goodwill is the value of a business, taking into account its reputation, established client base and profitability. It includes the acquisition of the pharmacy’s dispensing contract. When purchasing a pharmacy, goodwill usually comprises most of the cost. Fixtures and fittings are normally included as part of this cost. Other costs in addition to goodwill include stock and freehold premises (if available).

Examples of profits that can be generated

(p1), pharmacists can now obtain “pharmacy mortgages” that last 30 years (albeit with early repayment penalties applying during the first five years). George Knox, managing director of Medical and Professional Consultancy Ltd, the broker for these mortgages, told P1 Business Knowledge that a 100% pharmacy mortgage is possible with a wholesaler guarantee, or 80% without a guarantee. However, Mr Townsend warns that the overall repayments increase with the duration of such loans.

Goodwill

Mr Townsend calculates the “starting price” for goodwill payments (see “What is goodwill?” box, top right) for a pharmacy to be around seven times the business’s net profit. However, he adds, the actual value of goodwill is determined by the market. “Ultimately, sellers will only get what buyers are willing to pay.”

Goodwill differs depending on a pharmacy’s desirability and location. For example, buyers might pay £400,000 in goodwill for pharmacy with a net profit of £40,000 in some parts of the UK, whereas they might only pay £150,000 for a similar pharmacy in other areas.

Improving the business

So which pharmacy activity is most profitable — performing clinical services, dispensing prescriptions or selling over-the-counter medicines? Mr Townsend believes there is no simple answer. “A 20% gross profit on purchasing for dispensed medicines is achievable for many pharmacies,” he says. “On top of that, you can add professional fees for dispensing and payments for providing essential services.” (These are outlined in the Drug Tariff.)

He advises potential buyers to assess the net ingredient cost (NIC) on a pharmacy’s monthly NHS statements. A high NIC (£12 and above) often suggests that GPs prescribe larger quantities of medicines on repeat prescriptions, which means fewer dispensing fees for the pharmacy, he explains.

Mr Townsend estimates that offering clinical services (eg, minor ailments services, MURs, smoking cessation and emergency hormonal contraception) could add as much as £40,000 to a pharmacy’s “bottom line”. Furthermore, whenever medicines are supplied through such services they are paid for by the local primary care organisation. So, the only cost to the business is the pharmacist’s time.

Although some pharmacists struggle to find the time to offer clinical services, employing or training an accredited checking technician could help pharmacists spend more time out of the dispensary.

Profit from over-the-counter sales varies widely between products, says Mr Townsend, emphasising the importance of offering patients what they want. “When you buy a pharmacy you inherit patients and customers who will expect you to provide certain products. Therefore, it is probably not in your best interests to change everything too quickly.

“Product profit margins can differ from a few pennies per sale on some products to a 100% markup on others. It might be worth selling some products as “loss leaders” (ie, with little or no profit, or even at a loss) because if your customers cannot get their usual supplies from your pharmacy, they might shop elsewhere and take their prescription with them. Whatever you do, make sure you hold on to those customers!”

BUSINESS BYTES

Sell shares or sell assets?

Accountant Jon Chambers offers a useful business tip

When a company-owned pharmacy is sold (rather than a pharmacy owned by a sole trader), the sale can be conducted as a share sale or a trade and asset sale. The route chosen has tax implications for the seller.

In the former, full ownership of the company transfers to the buyer. When this happens, the buyer inherits the credit and trading history and any other liabilities of the company. For this reason, many buyers prefer an asset sale, which involves purchasing the goodwill and assets (ie, stock and lease/freehold) of the existing business without its history.

The consequences for the seller are related to the amount of capital gains tax (CGT) paid. If a share sale is carried out, the seller pays CGT on the profit generated from the sale. (For the first £1m, this is paid at a rate of 10%). If the pharmacy’s assets are sold, tax is paid at the “companies” rate — 21% for the first £300,000, 29.75% up to £1.5m.

Furthermore, this leaves the seller with a cash-rich company with no assets. The seller must then pay a further tax bill to remove the money from the company.

If you are selling your business and the buyer insists on an asset sale, you may wish to consider renegotiating the price upwards to offset the additional tax burden.

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