

Pharmacy val



In the first of a new series of columns, David Parker discusses business values in today's buoyant transfer market and asks if now's the time to sell or hold tight for the ride?

It's not only the property prices that appear to be the subject of hype alternating with uncertainty. Pharmacy values have, over the years enjoyed a similar rollercoaster ride. In this article we hope to shed some light on the true situation of pharmacy values

The most commonly used valuation principle for any type of business is that of valuing its future cash-flows. For some businesses this can be very tricky. In an industry that is very new, with no bases for comparison, or one which is very volatile, estimating future cash-flows involves more than its fair share of crystal-ball gazing. As a result, business values can be extremely subjective and, with hindsight, way off the mark.

The internet share-price boom is a classic example of people valuing a business based on anticipated future profits or cash-flows rather than current performance. Retrospectively it is known that these estimates, which were often based on very limited and sometimes poor information, were substantially overstated. Although it is mainly in the very new or the more volatile market sectors that we see such exceptional cases of "valuation gone mad", speculation exists within almost all markets.

Pharmacy values, though never subject to

the dramatic turns of fortune that befell some tech-stock investors, have nevertheless experienced significant changes in response to the market framework within which they exist. Thus the fear of total de-regulation following the OFT inquiry depressed goodwill values significantly. The eventual and much

Even the follow-up review by the DOH (The Galbraith review), the results of which are now overdue, seems to have passed everyone by without much real interest.

The atmosphere that existed only a few years ago was one of doom and gloom, where the misconception was that pharmacies would

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watered-down changes resulted in a rebound in values that has driven business values to a significant high-point. The reality is that the changes to the regulations have done precious little in terms of increasing competition and, save the odd brave soul that has exploited the 100hr exemption, the market remains virtually undiluted. The fear of de-regulation appears to have all but evaporated almost overnight.

be springing up on every corner and that the new contract would be the start of a dramatic erosion of revenue and simultaneous increase in workload. Indeed the doom-mongering was such that potential buyers became convinced that pharmacy earnings would decrease dramatically in the short to medium term, with the obvious effect of depressing demand for, and prices of, pharmacy businesses.

Values - Boom or Bust?

If we now view that as having been a "Bear market" we could equally describe the current one as rather "Bullish". There seems to be very little fear within the buyers' market and, as with the housing market, many are talking as if this is their last chance to get onto the ownership ladder or to build a chain with critical mass. Caution and discounting have been replaced by urgency and a willingness to pay a premium. Whilst rollercoaster markets make for good headlines and interesting, if sometimes dubious, anecdotes down at the pub, both buyers and sellers alike would do well to look through the current hyperbole to identify some clarity and sanity in the market.

It is all too easy for a few positive or negative market developments to become extrapolated to become a universal and rhetorical truth. You don't have to have spent too much time in the pub to have at some point known that "Of course Saddam has weapons of mass destruction". It seems only months ago that the world and his wife were share-tipsters telling us that "Marks and Spencer had had its day" and the most popular of all "You can't go wrong with property! (Try telling that one in Puerto Banus!)"

"So what is the reality with respect to pharmacy values?" you may be asking. Should you be rushing to cash in on the boom or holding out for the capital-growth ride of your life?

If we strip back the speculation, and look at the simple facts of the market, it could be

said that we are certainly in a more stable position than we appeared to be in three or four years ago. For that reason an increase over the values prevalent at that time is certainly justifiable. However, it should be noted that pharmacies are not generating significantly different profits than they were back then and that the cost of finance is generally heading north. The difference between yester-year's prices and today's can, therefore, only be put down to the significant, but intangible, confidence in the stability of the market.

Regardless of such exuberance, buyers still have to fund business acquisitions, just as first time buyers need to obtain a mortgage or property developers demand a commercial

time horizon of say 2-3 years the question is a little more difficult. Many pharmacists treat their goodwill as their pension provision and the value they extract is of great importance. However, almost all investment advisors will recommend a strategy of diversification in the years immediately preceding retirement. Holding all your eggs in one basket (particularly when that basket has been running at a premium for some time) is generally considered a risky strategy.

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return. Based on ability or capacity to fund acquisitions, businesses can readily justify values of between 6 and 10 times *normalised net cash-flow**. Depending on the circumstances some may achieve prices in excess of this, which is great news for sellers but should be recognised as the premium associated with the current "Bull market" as opposed to intrinsic value.

Although the pharmacy market is not expecting any significant wrecking-ball blows to profit in the short term, there is equally no reason to believe that pharmacy will be handed a significant increase in profits for the same work (The DOH won't make that mistake again!). For this reason, it is likely that the days of unbounded optimism and regular premium will gradually give way to more scientific financial rationale.

So is now the time to sell?

It is always hard to predict when a market has reached its peak, but what can be said with confidence is that anybody who was already considering selling their business in the immediate future can consider themselves very lucky. For those who had a slightly longer

abandoning your retirement plans. For example; some buyers may be prepared to consider concepts such as a gradual sale, a staggered sale (whereby exchange takes place but completion is deferred), an agreement to purchase at some fixed point in the future based on a predetermined price formula, a sale and management agreement etc. As well as allowing you to benefit from the current market, these schemes can offer a more gradual transition out of the business for the vendor and into the business for the purchaser, from which both may benefit. A good business transfer agent should be able to help you explore and execute any of these options.

* *Normalised net cash-flow* refers to the practice of adjusting existing accounting cash-flows to reflect those that may be expected under the ownership of the buyer; for example the delivery driver's salary may need to be adjusted to reflect that your husband or wife is no longer willing to do this as a gesture of goodwill or the gross margin may be adjusted to reflect the fact that the buyer has better wholesale terms than you do.

David Parker Consulting is a specialist in pharmacy business transfer and development. Visit www.davidparkerconsulting.co.uk or for information contact david@davidparkerconsulting.co.uk or call 0789 423 4873.



Don't put all your eggs in one basket by depending entirely on the goodwill of the sale to provide for your pension, says David Parker

