State of the Veterinary Market
Benchmarks, Profitability, Valuation and Transition of Your Practice

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- Managing partner/owner practices
- Bought a practice 1981–2001
- Started practice 1991–2001
- Merged a practice 1996
- Built/remodeled practice buildings
- Sold practices 2001
- Veterinary S & C Corporation, LLC, sole proprietorship, solo, group, multiple locations

Dr. Gary L Ackerman
- Provide consultant services for health care practice transitions and real estate.
- Licensed Commercial Real Estate agent
- Registered securities representative
- Registered Investment Advisor Rep
- Insurance licensed
- $250M+ Tax Deferred Investments
- 50+ Practice Sales

Topics
- Benchmarks
- Profitability
- Valuation
- Transition
- Taxation
- Info– www.businesstransitionservices.us

Veterinary Valuation Chain

Management

Profitability

Value

Veterinary Practice Management & Your Investment
- What did we go to school to do?
- Do we like managing?
- Do we like financial management?
- Is management a priority?
- Is my practice an investment or a job?
- Do I want to eventually sell my practice?
- What can I do to help the value of my practice?
- What is it worth?
- What do I need it to do for me in retirement?
Invite the Head Into the Heart Conversation

- “The only place where success comes before work is in the dictionary.”
- “In God we trust, all others bring data.”
- “If you can’t measure something, you can’t understand it. If you can’t understand it, you can’t control it. If you can’t control it, you can’t improve it.”
- “What gets measured gets done, what gets measured and fed back gets done well, what gets rewarded gets repeated.”

Benchmark Comparisons

- 2 studies – AAHA & WMP
- Many types of practices
- Utilize same measure(s) over same time
- Track with PM software so reported regularly
- Important for financial management
- Important for profitability
- Important for valuation

Benchmark Comparisons

- Prefer a current benchmark resource
- Set up your practice management and accounting software systems to benchmark
- Use the benchmark numbers to compare with your prior numbers plus national numbers
- Where do you expect DC area practices to be on the scale?
- You will be benchmarked in a valuation!
- More than I can go over.....

Staff Benchmarks

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>DVM : Staff Ratio</td>
<td>25th %</td>
<td>Median</td>
<td>Avg.</td>
</tr>
<tr>
<td>1 : 3</td>
<td>1 : 4</td>
<td>1 : 4.6</td>
<td>1 : 5.3</td>
</tr>
</tbody>
</table>

Staff Expense Benchmarks

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff-Related Expense</td>
<td>25th %</td>
<td>Median</td>
<td>Avg.</td>
</tr>
<tr>
<td>Wages &amp; Salaries</td>
<td>21.6%</td>
<td>20.2%</td>
<td>22.2%</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>n/r</td>
<td>n/r</td>
<td>n/r</td>
</tr>
<tr>
<td>Workers Comp</td>
<td>n/r</td>
<td>n/r</td>
<td>n/r</td>
</tr>
<tr>
<td>Benefits</td>
<td>1.1%</td>
<td>2.0%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Retirement</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Education</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>TOTAL</td>
<td>17.8%</td>
<td>22.8%</td>
<td>25.5%</td>
</tr>
</tbody>
</table>

| Source: Benchmarks 2013 A Study of Well-Managed Practices |
|---------------|-----------------|-----------------|-----------------|
| Staff-Related Expense | Avg. | Wages & Salaries | 21.6% |
| Payroll Taxes      | 2.0%  |
| Workers Comp       | 0.5%  |
| Benefits           | 2.5%  |
| Fringe Benefits    | 0.6%  |
| Total              | 27.4% |
Inventory Expense Benchmarks

<table>
<thead>
<tr>
<th>Inventory Category</th>
<th>25th %</th>
<th>Median</th>
<th>Avg.</th>
<th>75th %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drugs &amp; Medical Supplies (incl. Rx HW/flea)</td>
<td>9.8%</td>
<td>14.9%</td>
<td>17.0%</td>
<td>20.4%</td>
</tr>
<tr>
<td>Imaging</td>
<td>0.1%</td>
<td>0.3%</td>
<td>0.6%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Laboratory</td>
<td>2.1%</td>
<td>3.4%</td>
<td>4.3%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Therapeutic Diets</td>
<td>2.1%</td>
<td>3.0%</td>
<td>3.3%</td>
<td>4.0%</td>
</tr>
<tr>
<td>OTC (incl. non-Rx Flea/Tick)</td>
<td>0.4%</td>
<td>2.0%</td>
<td>2.7%</td>
<td>3.8%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>14.5%</td>
<td>23.6%</td>
<td>27.9%</td>
<td>33.4%</td>
</tr>
</tbody>
</table>

Source: Benchmarks 2013™: A Study of Well-Managed Practices

AVMA Expense Averages

<table>
<thead>
<tr>
<th>Expense Category</th>
<th>Avg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office and Equipment</td>
<td>$107</td>
</tr>
<tr>
<td>Hotel and Lodging</td>
<td>$120</td>
</tr>
<tr>
<td>Drug and Medical Supplies</td>
<td>$175</td>
</tr>
<tr>
<td>Pet and Animal Food Products</td>
<td>$206</td>
</tr>
<tr>
<td>Laboratory and Radiology Pamphlets</td>
<td>$117</td>
</tr>
</tbody>
</table>

Source: Benchmarks 2013™: A Study of Well-Managed Practices

Income Benchmarks

<table>
<thead>
<tr>
<th>Income Factor</th>
<th>25th %</th>
<th>Median</th>
<th>Avg.</th>
<th>75th %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth Rate</td>
<td>-2.0%</td>
<td>1.4%</td>
<td>1.3%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Total Income per FTE Veteranan</td>
<td>$374k</td>
<td>$419k</td>
<td>$416k</td>
<td>$453k</td>
</tr>
<tr>
<td>Net Income before owner compensation</td>
<td>9.8%</td>
<td>20.9%</td>
<td>22.6%</td>
<td>34.4%</td>
</tr>
</tbody>
</table>

Source: Benchmarks 2013™: A Study of Well-Managed Practices

Sector Revenue Benchmarks

<table>
<thead>
<tr>
<th>Revenue as % of Total Income</th>
<th>Avg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dentistry (incl. anesthesia)</td>
<td>1.7%</td>
</tr>
<tr>
<td>Surgery</td>
<td>4.5%</td>
</tr>
<tr>
<td>Hospital Services &amp; Tx</td>
<td>12.5%</td>
</tr>
<tr>
<td>Vaccinations</td>
<td>6.2%</td>
</tr>
<tr>
<td>Laboratory (inside &amp; outside)</td>
<td>12.6%</td>
</tr>
<tr>
<td>Pharmacy</td>
<td>4.5%</td>
</tr>
<tr>
<td>Other (therapeutic)</td>
<td>2.8%</td>
</tr>
<tr>
<td>Hospitalization &amp; Inpatient Tx</td>
<td>0.9%</td>
</tr>
<tr>
<td>Boarding</td>
<td>0.9%</td>
</tr>
<tr>
<td>Grooming</td>
<td>0.5%</td>
</tr>
</tbody>
</table>

Source: Benchmarks 2013™: A Study of Well-Managed Practices

AVMA Average Income Statistics

<table>
<thead>
<tr>
<th>Service Category</th>
<th>Avg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>$104</td>
</tr>
<tr>
<td>Feed</td>
<td>$125</td>
</tr>
<tr>
<td>Mixed Products</td>
<td>$267</td>
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<tr>
<td>Companion Products</td>
<td>$158</td>
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<tr>
<td>Companion Exams</td>
<td>$110</td>
</tr>
<tr>
<td>Exams</td>
<td>$148</td>
</tr>
</tbody>
</table>

Source: Benchmarks 2013™: A Study of Well-Managed Practices

Income Benchmarks

<table>
<thead>
<tr>
<th>Income Factor</th>
<th>Avg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACT (medical)</td>
<td>$89</td>
</tr>
<tr>
<td>Transactions per FTE Veteranant</td>
<td>3,225</td>
</tr>
<tr>
<td>Active clients per FTE Veteranant</td>
<td>800</td>
</tr>
<tr>
<td>New clients per FTE Veteranant</td>
<td>138</td>
</tr>
</tbody>
</table>

Source: Benchmarks 2013™: A Study of Well-Managed Practices
Utilizing Benchmarks

- Choose Benchmarks to track
  - Current stats (NCVEI)
  - Frequency
  - Different types for different people
    - Managers – employee, services, expenses
    - Owners – profitability, income, expense
    - Employees – ACT, production, services
- Set Goals
  - Share rationale
  - Invest staff – have them produce/review
  - Share results

Management of Benchmarks

- Identify those appropriate for your practice
- Identify strengths/weaknesses/trends
- Revise existing goals over time
- Manage frequency based on results
- Train appropriately
- Delegate training & monitoring if appropriate
- Results need to be known to be effective
- Consistency important

Focus on Complete Revenue

- Why wouldn’t revenue be complete?
  - Missed charges –100% profit – Invoice auditing?
  - Discounts – 100% profit
  - Missed opportunities to make a recommendation
    - Low hanging fruit!
- Best opportunity to be profitable lies in managing revenue
  - Treatment Protocols
  - Services offered consistently
  - Much of missing revenue is 100% profit!

Profitability

- Business side = *The Dark Side*
- Direct relationship to Valuation
- Direct relationship to lending or transition
- Greater profits = Higher valuation
- Business Strategies to drive profits but......
- More Profits = More Taxes
- Profitability for tax purposes versus profitability for valuation purposes

Profit

- A.k.a. net income, net revenue, owner’s return

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Expenses</th>
<th>Profit</th>
</tr>
</thead>
</table>

Busy ≠ profitable

Several common causes

Profit Percentage | Profit Grade
--- | ---
Above 18% | Superior
16-18% | Above Average
13-15% | Average
8-13% | Below Average
Less than 8% | Poor

Source: VetPartners No-Lo Worksheet

Managing for Tax vs Valuation

- Tax management goal is to reduce profits
  - Buy equipment at end of the year
  - Employ spouse/kids/relatives
  - Personal expenses/supplies/work done by staff
  - Other hobby/company support
  - Excess rent
  - Excess salary/401k contribution
  - Automobile purchase or deduction
  - Cash
- What does this do for valuation?? Added back to profits. 100% credit??
  - Clean up your act 3 years before a sale.
Practice Value

- Valuation
  - #1 – Directly dependent on profit
    - Well-managed practice profit 15–18%.
    - After expenses normalized
  - #2 – Location, Location, Location
    - Subjective
      - Typical veterinary valuation 4–5 x earnings
      - Equals 20–25% Return on Investment (ROI)
      - Creeping up…..

Valuation

- Income approach only (ask a bank/company)
- Profit x Earnings Multiple = Value
- Same profit ≠ Same value
  - VS
- Sales Comparison approach
- Replacement Cost approach

Current Transactions

- Valuation ≠ Sale Price!
- Metrics
  - Old rule – 100% of gross
  - Last 5 years – actual transactions 65–70% of gross
  - Last 2 years – 70–90% of gross
  - Recently 3–8x earnings, 30%–150% of gross
  - Vary based on buyer, location, financing…..

Other Valuation Factors

- Facility (Curb appeal + equipment)
- Growth in business (gross & net)
- Services offered
- Support staff leverage
- Quality/stability/dedication staff/Drs.
- Revenue per doctor (drives salaries)
- Management type (practice manager?)
- Vet Employment & Non-compete agr.
- Room to expand
- Regulatory history
- Buyer

Big Valuation/Transition Issues

- Complacency among veterinarians!
- Veterinary medicine is changing constantly!
  - Medicine/Technology/Demographics/Hospital design/Client services/Profit centers/Transitions
- Buyers need management help.
- Fear is prevalent
  - Practice debt
  - Student and housing debt
- Interest rates…..

Valuation Questions

- How profitable is your practice? Compared to others?
- What does your practice look and run like?
- Do you expect to sell your practice?
- When was the last valuation?
- Would you buy it?
Next Level Valuation Questions

- Is your practice one of your largest financial assets?
- Do you manage practice value like your other investments?
- Do you need your practice sale to contribute to retirement?
- What will you net from your practice sale?
- What kind of income will that provide?

Management Effects on Value

2014 gross income $1,461,000
2014 net profit $113,000
Net profit percentage 7.7%

 Likely Cap Rate of 4 (25%)
- Financing would likely be affected
  - Bank risk
  - Buyer risk
  - Higher interest rate

2014 Value $452,000

Management Effects on Value

If you changed nothing, you could expect about 2% growth per year
The reflected value over time would be:

- 2017 value $479,179
- 2024 value $529,590
- 2034 value $645,567

Management Effects on Value

The reflected value if simply increased profits would be:

- 2014 Value $452,000

Management Effects on Value

Because of increased profits:
- Reinvestment increased
- Risk premium decreased
- Valuation increased
- Cap rate increased to 5%

2017 value $479,179
2024 value $529,590
2034 value $645,567

Note: WMPs are targeting 15-18% profit
Management Effects on Value

- Which pathway would you prefer?
- Are you willing to lead your practice to higher profitability?
- The 20-year difference:
  - $4.17M additional profit
  - $2.5M additional value

- What if you used 20% of the additional profit for a tax deductible retirement plan?
  - Additional $2.5 million in retirement account (over and above)

Get educated
Prepare practice – first valuation may surprise
Prepare personal finances
Transition – Hire specialized advisors
  - Entity & Transaction attorney
  - Knowledgeable CPA
  - RE advisor
  - Transaction financial/tax planner
  - Broker

Accountant

- Buyer
  - Purchase – entity, tax structure of purchase, initial accounting.
  - Operation – budgeting, operational evaluation, annual tax planning.
- Seller
  - Tax accounting of sale critical
  - Different scenarios
  - Tax deferral options

Attorney

- Buyer
  - Transactional – Negotiation, Review and finalize all practice, real estate, loan, employment, non-compete documents. Cross purchase agreements???
  - Business – Entity formation, employment agreements, partnership agreements.
- Seller
  - Transactional
  - Specialty
  - Tax deferral – Trust or 1031 attorney
  - Financial &/or estate planning – Revise wills, set up trusts, new entities for asset protection.

Practice Purchases and Sales

- Appraiser
  - Valuation of practice pre-sale for partnership, financial planning or contingency planning.
  - Valuation at sale.
  - Profitability estimator.
  - Evaluation of likely buyer – inside, outside, corporate
  - Financing evaluation
- Realtor
  - FMV of building, lease, Broker Opinion of Value
  - Lease options
  - 1031 options

Practice Purchases and Sales

- Lender – Required unless cash purchase or all owner financing.
  - Asset based lender – typically bank, loan primarily on hard assets (real estate, equipment).
  - Cash flow based lender – loan based upon business cash flow and hard assets.
  - Seller – many sales require some owner financing subordinate to other loans.
  - Personal guarantees required by all.
  - Financing depends upon cash flow
**Practice Purchases and Sales**

- **Financial Planner**
  - Buyer – Set up long term plan.
  - Business plan and Qualified accounts
  - Personal plan and accounts
  - Seller – Change direction of plan.
  - Retirement financial plan – more income focused?
  - Generational financial plan
  - Tax deferral techniques – MANY
  - Tax advantaged accounts and investments
  - Estate planning

**Practice Transition Considerations For Buyers AND Sellers**

- Who is your Buyer?
- Typical Sale Structure
  - Asset versus stock sale
  - Type of entity
- Veterinary lending? Feasibility analysis?
- Understand factors influencing Valuations
  - 2 biggest surprises – valuation and taxes
- Net proceeds after tax? Get CPA analysis.
- What does the other side look like?
  - Does it match with retirement/family/estate plan?

**Practice Buyers**

- Inside
  - Associate
- Outside
  - Broker
- Corporate
- Merger???

*May require some owner financing or earn-out.*

**Sale to Associates – Pros & Cons**

- DVM continuity – helps valuation/transition
- Younger doctors – new blood & technology
- Very aggressive lender financing
- Succession plan guarantees future buyer and creates new credit history
- Great family and practice risk mitigation for death or disability.
- Less ROI for seller. Control?

**Financing**

- Specialized healthcare lenders have the best rates and most knowledge.
  - SBA more onerous but may be only choice
  - Some 100%+ financing
  - Sometimes linkage to other accounts

**LENDER RED FLAGS – BUYER**

- Low Credit Score – Require 680 minimum
- CHECK YOUR BUYER’S CREDIT EARLY
- Extremely high living expense needs, high credit card debt, bk, living beyond means
- Experienced veterinarian – weak financial st.
- Skill set of Buyer does not compare favorably
- Purchasing as an “investment” &/or current practice is performing poorly
LENDER RED FLAGS FOR THE VETERINARY PRACTICE
- General rule – if the lender is questioning something you should be concerned
- Declining or erratic revenue figures
- Associate(s) produce a large portion of the practice revenue and the associate was not offered/did not accept the right to acquire
- Specialists produce substantial portion of practice revenue & buyer can not reproduce
- Staff turnover
- High revenues with low active patients

Seller Taxes
- 2013 Tax Law changes made worse – 33–60%
- Equipment/Fixtures – ordinary income – 0 basis
- Inventory, AR, Non–Comp – ordinary income.
- Goodwill/Stock – Capital gains (15%–20%)
- Real estate depreciation – RE recapture (25%)
- State Taxes (5.75%).
- Higher Income taxes
  - 3.8% Medicare Tax – investment income
  - Stealth Tax – Loss of exemptions/deductions
  - AMT

Tax Mitigation on Sale
- Typically can eliminate/defer 90–95% taxes
- Real Estate – 1031 Exchange
  - Best tax strategy – May never pay tax.
- Practice – LLC Installment sale
  - Proceeds to national custodian (Schwab)
  - Similar to IRA – tax deferred growth & income
  - Upon death may pay tax or continue deferral
  - Construct for Income – Growth – Legacy
  - Income typically 30–50% higher than taxable sale

Tax and Deferral Options
- Sale – Pay taxes
- Installment sale to buyer – Deferred taxes + Credit risk. Good lenders so not necessary today. Rates bad for sellers and buyers
- Entity Installment Sale (tax deferred through family LLC)
- 1031 Real Estate Exchange
- 721 Exchange – Merger/contribution

1031 Exchanges
- Multiple rules to comply with.
- 45 days to identify, 180 days to transact.
- Replace all debt (if present) and equity for complete tax deferral.
- Purchase like-kind replacement property
  - Very broad
- Typically investment property purchase, usually for cash flow (rent).
- Best option for not paying taxes

LLC Installment Sale
- Asset sale that has gains. Business – real property – private assets.
- Installment note to Seller from family LLC.
- Terms negotiable. I/O or amortizing.
- Pledge/lien of custodian account
- Typical term 5–30 years
- Same investments as personal accounts
- Similar to IRA/401K planning
Tax Deferral Sample – $1M Sale

<table>
<thead>
<tr>
<th>Net Proceeds</th>
<th>With Tax Deferral</th>
<th>Increased Income on Portion Tax Deferred</th>
</tr>
</thead>
<tbody>
<tr>
<td>After Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Virginia/MD</td>
<td>$708,500</td>
<td>$958,250</td>
</tr>
<tr>
<td>Practice Sale</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Virginia/MD</td>
<td>$753,625</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Real Estate Sale</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Practice Sale Results Comparisons

<table>
<thead>
<tr>
<th>Case Study</th>
<th>2017</th>
<th>2023</th>
<th>2034</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.7% Profit</td>
<td>$479,179</td>
<td>$381,304</td>
<td>$645,567</td>
</tr>
<tr>
<td>Net after Tax</td>
<td>$59,179</td>
<td>$1,599,583</td>
<td>$1,704,798</td>
</tr>
<tr>
<td>Add Value</td>
<td>$381,304</td>
<td>$1,599,583</td>
<td>$1,599,583</td>
</tr>
<tr>
<td>16% Profit/4% growth</td>
<td>$657,216</td>
<td>$1,122,900</td>
<td>$1,519,603</td>
</tr>
<tr>
<td>Net after Tax</td>
<td>$657,216</td>
<td>$1,122,900</td>
<td>$1,519,603</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>$866,795</td>
<td>$866,795</td>
<td>$866,795</td>
</tr>
</tbody>
</table>

Retirement Income from Sale

*Ask yourself / advisors:*

- Have you put aside enough money to retire? Or do you plan to continue to work? Will you have to work forever?
- Will you sell your practice?
- For how much? And to whom?
- What portion of your retirement portfolio is supposed to be generated from your practice sale?
- Do you know what retirement income you will need?
- How much of that needs to be generated from your practice sale?
- Is a greater practice value better at that time?
- Is a lower tax bill better?
- Do you need cash or income? Cash comes at a tax cost.

SUMMARY

- Check your stats – will affect your practice!
- Management skills can increase profitability
- Grow profitability to maximize valuation
- Preparation is key – practice and personal
- Valuation is objective and subjective
- Financing is readily available for buyers
- Advisors will be required
- Taxes are numerous & rates are increasing
- Tax deferral & transaction planning helpful

State of the Veterinary Market

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