

State of the Veterinary Market

Benchmarks, Profitability, Valuation and Transition
of Your Practice

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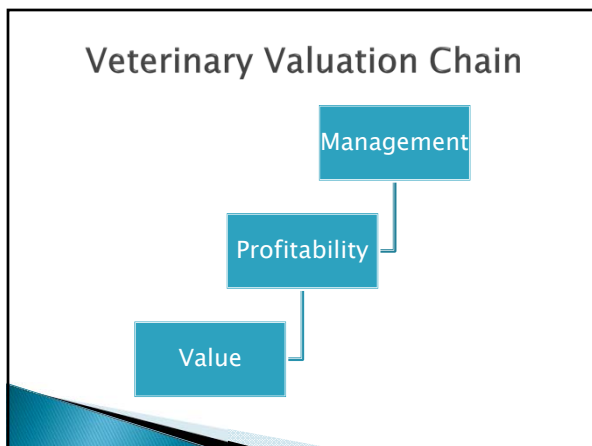
- ▶ Managing partner/owner practices
- ▶ Bought a practice-1981-2001
- ▶ Started practice-1991-2001
- ▶ Merged a practice -1996
- ▶ Built/remodeled practice buildings
- ▶ Sold practices 2001
- ▶ Veterinary S & C Corporation, LLC, sole proprietorship, solo, group, multiple locations

Dr. Gary L Ackerman

- ▶ Provide consultant services for health care practice transitions and real estate.
- ▶ Financial-Tax-Retirement Income Planning
- ▶ 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 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.....

Benchmark Comparisons

- ▶ Many factors influence:
 - Client Demographics
 - Geographic Location
 - Setting: Urban, Suburban, Rural
 - Practice Type
 - Practice Size
 - Practice Age
 - Hours of Operation
 - Management Support
 - Economics

Staff Benchmarks

Source: 2013 AAHA Financial and Productivity Pulsepoints™ 7th Edition

DVM : Staff Ratio				
25 th %	Median	Avg.	75 th %	Avg.
1 : 3	1 : 4	1 : 4.6	1 : 5.3	1 : 4.3

Staff Expense Benchmarks

Source: 2013 AAHA Financial and Productivity Pulsepoints™ 7th Edition

Staff-Related Expense	25 th %	Median	Avg.	75 th %
Wages & Salaries *	16.7%	20.2%	22.2%	24.0%
Payroll Taxes	n/r	n/r	n/r	n/r
Workers Comp	n/r	n/r	n/r	n/r
Benefits	1.1%	2.6%	3.3%	4.2%
Retirement	+	+	+	+
Education	+	+	+	+
TOTAL:	17.8%	22.8%	25.5%	28.2%

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

Staff-Related Expense	Avg.
Wages & Salaries *	21.6 %
Payroll Taxes	2.0%
Worker's Comp	0.5%
Benefits	2.1%
Retirement	0.6%
Education	0.5%
TOTAL:	27.8%

Inventory Expense Benchmarks

Source: 2013 AAHA Financial and Productivity Pulsepoints™ 7th Edition

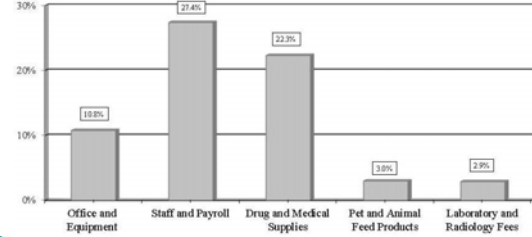
Inventory Category	25 th %	Median	Avg.	75 th %
Drugs & Medical Supplies (incl. Rx HW/flea)	9.8%	14.9%	17.0%	20.4%
Imaging	0.1%	0.3%	0.6%	0.7%
Laboratory	2.1%	3.4%	4.3%	4.5%
Therapeutic Diets	2.1%	3.0%	3.3%	4.0%
OTC (incl. non-Rx Flea/Tick)	0.4%	2.0%	2.7%	3.8%
TOTAL:	14.5%	23.6%	27.9%	33.4%

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

Inventory Category	Avg.
Drugs & Medical Supplies (incl. Imaging)	9.8%
HW/Flea/Tick	3.9%
Laboratory	4.0%
Therapeutic Diets	2.9%
OTC	0.4%
TOTAL:	24.0%

AVMA Expense Averages

Figure 13. Selected expense categories as a percentage of revenue in 2011



Income Benchmarks

Source: 2013 AAHA Financial and Productivity Pulsepoints™ 7th Edition

Income Factor	25 th %	Median	Avg.	75 th %
Growth Rate	-2.0%	1.4%	1.3%	6.5%
Total Income per FTE Veterinarian	\$374k	\$491k	\$516k	\$593k
Income per sq. ft.	\$150	\$205	\$221	\$261
Net Income (before owner compensation)	9.8%	20.9%	22.6%	34.4%

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

Income Factor	Avg.
Growth Rate	n/r
Total Income per FTE Veterinarian	\$632k
Income per sq. ft.	n/r
Net Income (before owner compensation)	n/r

Sector Revenue Benchmarks

Source: 2013 AAHA Financial and Productivity Pulsepoints™ 7th Edition

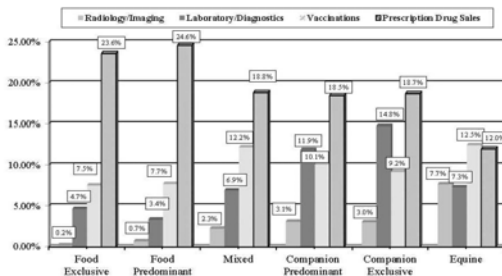
Revenue as a % of Total Income	25 th %	Median	Avg.	75 th %
Dentistry (incl. anesthesia)	1.7%	2.8%	3.8%	4.4%
Surgery	4.5%	6.8%	7.9%	9.5%
Outpatient Services & Tx	12.9%	18.0%	18.0%	22.7%
Vaccinations	6.2%	8.2%	9.4%	11.4%
Laboratory (inside & outside)	12.4%	15.4%	16.7%	19.0%
Pharmacy	12.6%	17.3%	18.8%	23.1%
Imaging	2.4%	3.6%	4.1%	4.8%
Diets (therapeutic)	2.8%	4.2%	4.6%	5.6%
Hospitalization & Inpatient	0.9%	1.8%	2.8%	3.5%
Boarding	1.7%	3.9%	4.9%	6.6%
Grooming	0.5%	1.4%	2.9%	3.9%

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

Revenue as a % of Total Income	Avg.
Dentistry	2.5%
Surgery	5.5%
Exams & Professional Services	14%
Vaccinations	6.8%
Laboratory (inside & outside)	18.8%
Pharmacy	22.2%
Imaging	4.9%
Diets (therapeutic and retail)	4.2%
Hospitalization & Inpatient Tx	6.3%
Boarding	3.0%
Grooming	1.2%

AVMA Average Income Statistics

Figure 12. Selected service categories as a percentage of practice revenue in 2011



Income Benchmarks

Source: 2013 AAHA Financial and Productivity Pulsepoints™ 7th Edition

Income Factor	25 th %	Median	Avg.	75 th %
ACT (medical)	\$89	\$114	\$114	\$133
Transactions per FTE Veterinarian	3,225	4,195	4,532	5,443
Active clients per FTE Veterinarian	800	1,103	1,538	1,852
New clients per FTE Veterinarian	138	203	246	307

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

Income Factor	Avg.
ACT (medical)	\$173
Transactions per FTE Veterinarian	5,405
Active clients per FTE Veterinarian	1,005
New clients per FTE Veterinarian	198

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

- ▶ Busy ≠ profitable
- ▶ Several common causes

Profit Percentage	Profit Grade
Above 18%	Superior
16-18%	Above Average
13-16%	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

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

2014 Value \$452,000

Likely Cap Rate of 4 (25%)

- ▶ Financing would likely be affected
 - Bank risk
 - Buyer risk
 - Higher interest rate

Management Effects on Value

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

Case Study	7.7% Profit 2% Growth	2014 Value \$452,000
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Management Effects on Value

- ▶ Conversely...with AVERAGE veterinary profits:
 - Significant cash flow increase
 - Reinvest in the practice
 - Improve facility (curb appeal)
 - Improve equipment
 - Veterinary production should increase
 - Veterinary salaries increase
 - Valuation increase
 - Reinvestment will also:
 - Stimulate increased revenues
 - Decrease risk premium

Management Effects on Value

- ▶ The reflected value if simply increased profits would be:

Case Study	2017 Value	2014 Value \$452,000
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Management Effects on Value

Because of increased profits:

- ▶ Reinvestment increased
- ▶ Risk premium decreased
- ▶ Valuation increased
- ▶ Cap rate increased to 5

Case Study	7.7% Profit 2% Growth	
2017 value	\$479,179	4%
2024 value	\$529,590	5%
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 \$2.5million in retirement account (over and above)

Management of Your Practice Investment

- ▶ 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 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

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**

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

	Net Proceeds After Tax	With Tax Deferral	Increased Income on Portion Tax Deferred
Virginia/MD Practice Sale	\$708,500	\$958,250	38.41%
Virginia/MD Real Estate Sale	\$753,625	\$1,000,000	32.69%

Practice Sale Results Comparisons

Difference in Investable Assets for Retirement:

Case Study

	7.7% Profit/ 2% Growth	Net after tax	Add Value	16% Profit/ 4% growth	Net after tax	Defer Taxes	Net Invested Amount
2017	\$479,179	\$345,008	➡	\$912,800	\$657,216	➡	\$866,795
2024	\$529,590	\$381,304	➡	\$1,599,583	\$1,122,900	➡	\$1,519,603
2034	\$645,567	\$464,808	➡	\$2,367,774	\$1,704,798	➡	\$2,249,385

- ### 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

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