

The purchase and exit process

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Abstract

A successful practice purchase, sale, buy-in or buy-out is a life-changing event for all involved. It is worth making the time to plan your ideal purchase or sale and then a backup plan or two. All involved should make decisions with full knowledge of the relevant facts and have a plan that once put into place, will get you where you want to be, when you want to be there. The material provided in these proceedings is intended to supplement the session taught at the Conference. While the information below is written for the buyer/seller, it is important the practice manager/administrator also be familiar with the process and potential pitfalls – she/he is a part of the ongoing core of the practice and can have significant influence on the stability and success of a transaction.

Key words: veterinary, practice, sale, purchase

Résumé

L'acquisition, la vente, l'achat ou le rachat d'une pratique performante est un évènement qui change la vie pour tous ceux qui sont impliqués. Il vaut la peine de prendre le temps de planifier votre acquisition ou vente idéale et d'avoir un plan de rechange ou deux. Tous ceux concernés devraient prendre des décisions avec pleine connaissance de tous les faits pertinents et avoir un plan qui lorsqu'il sera entamé vous guidera vers ce que vous voulez quand vous le voulez. Le matériel présenté dans ces minutes a comme but de compléter la session enseignée lors de la Conférence. Bien que l'information qui suit soit écrite pour l'acheteur/vendeur, il est important que le gestionnaire/administrateur de la pratique soit familier avec le processus et les dangers potentiels. Cette personne fait partie du noyau de la pratique et peut avoir une grande influence sur la stabilité et le succès de la transaction.

Common Pitfalls for Buyers

Avoid Making Life Changing Decisions until Closing

An unscrupulous seller can take advantage of an overly eager buyer who quits his or her job, sells his or her house, or purchases a new house before the terms of the purchase agreement are finalized. An aggressive seller might raise the purchase price and/or be less willing to negotiate reasonable terms if he or she knows that the buyer is dependent on the purchase being finalized. It is unwise from a negotiation standpoint and will cause undue stress to a buyer and his or her family, if they put themselves in a position that they

have to accept unreasonable contract terms because they have made major life decisions that rely on completing the practice purchase.

Establish Good Credit

Many prospective buyers feel that they will not be able to buy a veterinary practice because they still have large student debt obligations and/or have no meaningful savings. The reality is that a large percentage of successful practice buyers have faced those same challenges, but in most cases they have had another important "asset" – a high credit score. Although the dynamics of veterinary financing are always in a state of flux, with interest rates and loan terms constantly changing, people that have established good credit are best positioned to capitalize on the acquisition opportunities available.

Don't Buy any Business until you Understand Cash Flow

Business fundamentals are not rocket science, but some people seem to think they are. Like any other area of endeavor, the world of business finance has its own vocabulary and can be analyzed to a highly technical and complicated degree. The basics of cash flow, however, whether viewed from a personal or business perspective, are surprisingly basic and easy to grasp.

Cash flow is quite simply the funds generated from some activity, and they are the life blood of any business. Anyone who purchases a business without an appreciation of how revenues, operating expenses, capital expenditures, debt service, and the like impact cash flow is essentially "flying blind."

Start Looking at Practices Long Before You Plan to Buy

Although everyone is familiar with the concept of "window shopping," many fail to realize its importance in the context of a veterinary practice acquisition. Trade journals, postings at veterinary conferences, and veterinary practice brokers routinely list practices for sale. By beginning to pay attention to the practices that come on the market, prospective buyers can get a better sense of what types of opportunities they are attracted to, the general availability and price range of those practices, and the veterinary practice market at large. Sometimes, the most helpful education occurs through the simple process of just looking around.

If you are buying the practice where you are working, you should start paying attention to how the current owner(s) are managing the practice and the team. Request to be involved in the decision making. Note what you like about what the owner(s) do and do not do. This is a prime opportunity for on the job owner training.

Prepare Yourself for Practice Management

While it makes sense to learn about buying a practice at an early stage, it also makes sense to learn about owning one. For years, practice management tracts have been available at all of the major veterinary conferences, and they provide an excellent opportunity to look at a veterinary practice through the eyes of an owner. There are also a myriad of other practice management resources available online and in print.

Common Pitfalls for Sellers

While every practice ownership transaction is different, there are certain common pitfalls and traps for owner/sellers to consider.

Give Staff Raises

We've encountered a number of veterinary owners who prior to selling will give raises to the staff. There are always a myriad of reasons – no raises in a long time, wanting to reward loyalty before leaving, and as a way to ensure employees are taken care of, etc. All nice sentiments, but this can definitely impact a transaction and purchase price.

A raise can be appropriate if it is earned and a part of a regularly scheduled event, or if your staff are currently being paid below local economic or profession standards. However, any bump in salary that is not planned for with a corresponding increase in revenues will reduce the profitability of the practice and thereby its value. If you feel you need to reward certain dedicated employees, it's better to provide a closing bonus to them out of the sale proceeds.

Change Your Accounting Methods

It is best for sellers to avoid accounting system changes, such as moving from cash to accrual accounting, re-categorizing expenses differently than you have done recently, changing accountants who then shift your structure, etc. Buyers and their lenders will analyze a practice's financials and they expect verifiable results. They will assess the cash flow to determine 1) if the value is fair and 2) where risk/opportunities lie. Inconsistencies in expenses and shifts in organization can make buyers and lenders wary about the reliability of the earnings projections. This could result in a lower offer price or worse, it could turn the buyer off the practice altogether.

Making Significant Change to Employee Benefits

Unless you are reducing the expense to the practice, making significant changes in employee benefit plans should be avoided for the reasons provided above. Also keep in mind, continuing employee benefit plans is at the discretion of the new owner. Depending on the trend in the benefit costs, it may or may not be sustainable for the new owner post-closing. Receiving a benefit only to have it taken away could create friction between the staff and the new owner, which could set everyone up for failure.

Purchase Excess Inventory or Deplete Inventory

Almost all practice value determinations include an operational level of inventory in the practice price. This means that a "normal" inventory level must be present at closing. Most contracts will provide for a physical count of the inventory prior to closing. If there is an excess amount or if the inventory has been depleted, the closing can be disrupted and/or purchase price adjustment may be warranted.

Purchasing High-end Equipment or Engaging in New Leasing Arrangements

The practice earnings (profits) drive the value of the practice, period. Purchasing new equipment may increase a practice's attractiveness to a potential buyer, but it is not likely to increase the value of the practice unless the equipment is used to generate new revenues that lead to greater earnings. When you are planning an exit, such investments may make sense if you have the time to produce the return on the investment.

On the leasing side, having lease agreements can create complications during a practice sale transaction, even when the lease "pays for itself" through details in the agreement. While there are exceptions, in most transactions, the leases are paid off at closing. They do not transfer to the new owner. Just because the lease agreement is transferable or assignable does not mean that the buyer will accept the transfer and the obligated relationship. Entering into new binding agreements during your exit planning should be done cautiously and with great attention to detail.

Starting to Coast Before the Exit

The practice value is based on what the practice is currently doing. Having easy potential to increase revenues by expanding hours, increasing marketing or providing more services definitely adds attractant value for a buyer, but it does not add value. Buyers aren't interested in paying owners for the work that they will do to make the potential real. Practice owners that start coasting (cutting back hours, limiting services provided, etc.) can risk impacting the practice value significantly, which can make for a very different exit than expected.

Not Having Your Practice Valued

It is the owner's responsibility to set the price of the practice. Ideally this would come from a veterinary practice appraiser. However, an owner is entitled to put any price on their practice that they want. Doing so, though, does not mean a buyer will pay it. While there is still the occasional fool, almost all buyers will test the price with their advisors, lenders, and accountants. If the purchase price is not realistic, the negotiations can come to a standstill, with both parties now distrustful of the other. Additionally, for the seller, it's a poor way (and poor timing) to find out that their practice (a major retirement asset) is not worth as much as they thought.

Related to this is sharing the practice financial and operational data with the possible buyer before the valuation is complete. As the owner/seller, it can be challenging to commit to a transaction before you have all of the details involved in your decision. Value the practice first, commit to an exit, and then begin the process with your buyer. Resist jumping ahead in the sequence.

Ignoring Facility and Equipment Care and Maintenance

Whether the facility is going to be leased or sold, the buyer will most likely have a building inspection performed and will test all of the equipment. When multiple issues surface, a buyer can start to wonder about the conditions of things that are not so visible. It can be overwhelming to a potential buyer to realize that not only will they have the new challenge of business ownership but that they will also have to deal with the hassle of facility repairs. This can often add a new round of negotiations prior to the closing which often result in purchase price adjustments. As you plan your exit, engage a building inspector and fix the issues long before transaction process starts.

Sharing the News Prematurely

This is an exciting and transformative event for all involved. Sharing the news before it becomes real though, can create many issues for your staff, your clients, your community, and for the buyer and the transition.

A pending practice sale can cause a lot of unrest and speculation among staff which sometimes translates into employee turnover. If clients find out, some may start looking for another veterinarian rather than wait and give a new buyer a chance. The practice needs to remain stable and financially healthy while the right buyer is found. Once a buyer is located, there will be plenty of time to answer questions and provide assurances before the transition actually happens. Have a plan for the announcement.

Waiting too Long to Plan

This is a very common mistake. Don't wake up one day and decide "now is the time to sell!" There are many details to prepare including appraisals (practice and real estate), building inspections, tax implications, and the retirement plans such as cash flow, health insurances, and what you are going to do with you time. Additionally, if you do not have

a buyer already, you may need to find one on the market. We have our buyer list with over 450 people waiting for a practice, but if none of them want to move to where you are, it may take some time to find the one who does.

Transactions and Transitions

The transaction process typically takes several months. It is important to start early, and typically the first step is to have the practice appraised by a qualified practice appraiser. While an owner is entitled to put any price on their practice that they want, it doesn't mean a buyer will pay it. Most buyers will test the price with their advisors, lenders, and accountants. If the purchase price is not realistic, negotiations will quickly stall. Because for many owners, their practice is a major component to their retirement portfolio, it is poor timing to find out during negotiations that their practice is not worth as much as they thought.

For all involved, it is best to work with a good team of qualified advisors. There are a number of advisors a practice owner should engage when selling their practice. Key ones can include appraisers, attorneys, accountants, retirement planners, brokers, etc. It is important to use advisors that are experienced in veterinary business sales transactions. This can help both with the transaction and its details as well as with the transition preparations. Additionally, differing sales structures, such as the purchase price allocation and/or stock vs asset sales, have significant tax implications to the seller. It is important that your advisors are prepared and knowledgeable about these negotiating points so that they can help you can make fully informed decisions when the time comes.

Finally, it's important that the business continues to fully operate during the negotiation and transaction process. Maintaining "business as usual" can help the team and the clients through the transition.

Acknowledgement

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