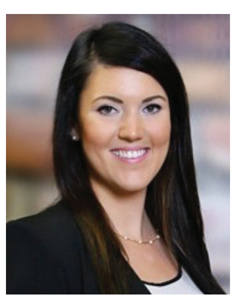
Best in Show: Why Practice Valuation Is Smart Business

Routine business checkups provide a starting point for developing a management roadmap, identifying growth opportunities and enabling a higher sale price for your practice.

By Mary Beth Koester, CVA

Your love of animals, not your love of business, fuels your desire to be the best veterinary practice owner you can be. But without a solid business structure in place and a plan designed to help you meet your goals, there's a good chance you won't fulfill your vision.



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To keep employees paid and the lights on, practice owners often wear many hats. During times of high stress and increasing demands, you'll most likely have to triage the situation to ensure that critical issues (e.g., seeing patients, following up with clients, dealing with staff problems) remain your top priority. Just remember that when you spend the majority of your time in the trenches, it becomes harder to see the bigger picture. A practice owner should always begin with the end in mind, but it's never too late to start the process.

PRIORITIZE PRACTICE HEALTH AND WELLNESS

Just as they perform routine wellness exams on patients, practice owners must prioritize regular checkups on their business. Not only will this exercise enable you to spot red flags before they become pressing issues, but it will also help you develop the strategies necessary for increasing your practice's profitability, streamlining the succession planning process and growing an abundant nest egg for your future.

To set a course that will help you reach your desired destination, you must first determine your starting point. Knowing your practice's true value tells you its worth to an interested buyer today and illuminates areas of opportunity and key drivers that will affect its value tomorrow. Equipped with that knowledge, a practice owner can work with a trusted business adviser to develop a road map for improving practice profitability and, ultimately, value.

FACTORS THAT DETERMINE PRACTICE VALUE

A practice's value is determined by both internal and external factors, including how the professional valuator applies different approaches and methodologies. In a nutshell, the three driving factors that affect value are cash flow, rate of return, and sustainable growth. Here's how it breaks down.

Financial Position

We've all heard the phrase "cash is king." Well, cash enjoys a healthy reign over veterinary practices. Your practice's cash flow is a key driver of value and an excellent indicator of future return on investment. Additionally, cash flow trends are very important. Irregularities and volatility from year to year can cause concern for a potential buyer, whereas a trend of consistent growth is more reassuring. Listed below are other financial factors to consider.

- **Retirement:** If you're planning to retire in the next three to five years, start preparing for the sale today so that when your cash flow level reaches its peak, you will be in a better position to seize the opportunity.
- **Clean books:** Clean financial records lessen a buyer's perceived risk. So, if you tend to run nonpractice expenses (e.g., personal vehicle, family cellphone plans, personal vacations) through the books, begin separating them out so that your practice's financial statements reflect only true practice expenses.

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- **A second set of eyes:** Financial statement reviews or audits by an outside accounting firm and strong internal controls increase the confidence of potential buyers, making your practice more desirable.

Goodwill

If your practice relies on the work of a single doctor who knows every client and treats every patient, then your reputation and your practice's reputation are, essentially, viewed as one and the same. This situation becomes problematic when it's time to transfer goodwill in a sale.

The difficulty or ease with which goodwill is transferred from seller to buyer depends on whether it belongs to the owner (professional/personal goodwill), the practice (enterprise goodwill) or a combination of the two.

In a one-doctor practice where the goodwill is significantly professional goodwill, there is a chance that when the owner leaves and the buyer takes over, the clients and patients will leave, as well. To avoid this type of risky situation, a transition plan is essential. It should outline the steps and actions you and the buyer will take to introduce the buyer to clients and staff and reinforce the buyer's veterinary skills and professionalism.

In comparison, a multiowner and multidoctor practice that has sound management systems in place, a medical protocol that is practiced consistently and clients who are seen by different veterinarians in the practice is an example of enterprise goodwill. In this situation, clients are bonded to the practice – its reputation and brand – rather than to one specific doctor. A practice that has built up its enterprise goodwill is a less risky investment to a potential owner because the goodwill is easier to transfer in a sale.

Timing

If you are making plans to sell your practice, be aware of how important timing can be in maximizing its value. With good planning, you can aim to exit your practice at the height of its performance. But, as often happens in life, your plans may be affected by unforeseen events, such as owner burnout or illness. Here are three considerations that can impact your practice's value.

- **Burnout:** Practice owners suffering from burnout are less likely to pay close attention to the little things, and all those little things can add up and make a huge impact on the bottom line. Additionally, when an owner becomes unmotivated to manage, the staff often perceives the change and the practice culture shifts accordingly. When employees are less motivated and engaged, productivity and efficiency decrease. In the end, the practice's value suffers.

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- **Mentorship:** If your plan is to sell your practice to an associate veterinarian, having enough time to implement a mentorship program is key to a successful transition. Depending on the associate's level of experience, the process of preparing for ownership could take anywhere from one to three years.
- **Interest rates:** Interest rates and credit availability can affect the sale of your practice. When interest rates drop, borrowing costs are lower, which means a potential buyer can afford to pay more.

Buyer

The reason behind your decision to conduct a practice appraisal (e.g., sale, divorce, litigation, buy-sell agreement, financing), as well as the type of buyer to whom you are selling, can also affect the overall value of your practice.

The fair market value standard, which is used in most valuations, assumes that the hypothetical buyer will have the same resources and overhead as the seller. This is different from the investment value standard, which attempts to quantify certain synergistic advantages for the buyer. The investment value is typically higher than the fair market value due to the added synergies a potential buyer, such as a corporate consolidator, may have.

GET MORE VALUE FROM YOUR PRACTICE

Regardless of the reason or purpose, having your practice valued is advantageous for business and succession planning. Not only does it provide you with the starting point for developing a management roadmap by highlighting important financial ratios and trends, it also identifies key areas of opportunity for growth and increasing profitability. A valuation allows you to benchmark your practice to key performance indicators and provides a measurement for your growth and success. VMD

VETERINARY PRACTICE GROWTH STARTS HERE

- **Cash flow:** Increasing gross margins and decreasing operating expenses lead to increased sustainable cash flow, which equates to a higher practice value.
- **Rate of return:** The rate of return required by an investor incorporates the level of risk an investor is willing to accept to own your practice versus another practice. Riskier practices are viewed as less valuable to investors. Identifying and minimizing risk areas is key for increasing your practice value.
- **Sustainable growth:** Continued sustainable growth adds value to the practice. Closely monitoring revenue and profitability and developing strategies for sustainable growth increase the value of your practice.

Ms. Koester is the manager of valuation services at Rea & Associates, an accounting and business consulting firm in Dublin, Ohio. She is a certified valuation analyst, has written for many veterinary publications and has been a member of VetPartners for over five years. Visit www.reacpa.com/veterinary-valuations to learn more about the benefits of a practice valuation.