

## Orderly Exit – Planning your Exit Strategy

**PACIFIC VETERINARY  
CONFERENCE 2011**  
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## How to Exit?

- An age old problem
- How do I exit successfully and gracefully from the veterinary practice I've worked so long and hard to build?

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## Why it is Trickier?

- Growing Urgency
  - Veterinary Industry has large population of older owners
  - All looking to retire in relatively near future
- Tougher economic times
  - Pickier buyers
  - Tougher financing
  - Dropping real estate values

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## Keys to Success

- Planning Ahead
  - Timing
  - Dollars
  - Getting ready
  - Finding Buyer
  - Analyzing all options available
  - Post Retirement Plans

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## Goals of the Exit Strategy

- Financial Security
  - What do you need?
- Legacy
  - How important is this to you?
- Staff Security
  - Taking care of your people
- Clients Cared For
- Transparent Changing of the Guard

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## Are you prepared for all that is involved...

- Knowing what to expect in the process throughout the sale – start to finish
- Getting the place ready to sell
- Analysis of your own books and tax returns – how do they look?
- Timing

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## Are you prepared for all that is involved...

- Understand the value of your veterinary practice
  - Tangible assets versus intangible assets
  - Methods
  - Cash flow
  - Capitalization Rate
- Buyers-finding them and dealing with them
- Terms of the transaction - what do you want?

## Are you prepared for all that is involved...

- Cash flow - knowing what you'll end up with
- Tax Ramifications
  - Timing
  - Allocation of sales price
- Transition-Getting the buyer in and everything transferred smoothly
- Helping buyer succeed

## Are you prepared for all that is involved...

- What documents you'll need for the sale
- A graceful final exit
  - Go out like John Wooden?
  - Go out like Woody Hayes?

## Real Life Examples

## Real Life Stories

### Seller #1

- Planned for practice sale three years ahead of time
- Groomed associate to buy practice
- Books and tax returns were clean and easy to explain
- Facility and equipment were in good condition
- S Corporation

## Real Life Stories

### Seller #1

- Had the practice properly valued
- Made clear the terms that were wanted
- Wasn't in a rush to sell
- Negotiations and legal went smoothly
- Seller received close to asking price - \$1,200,000.
- Happy Ending

## Real Life Stories

### Seller #2

- Got close to burn out and impulsively decided to sell
- Associate wasn't interested, so seller went to street
- Books and tax returns were a mess. Multiple perks and personal expenses running through practice
- Facility and equipment were in decent condition



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## Real Life Stories

### Seller #2

- Used rule of thumb to come up with asking price
- Wanted to close deal ASAP!
- Negotiations and legal were a disaster
- Seller should have received same \$1,200,000. Instead, received \$860,000.
- **Unhappy Ending**



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## Making the Decision



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## Deciding to sell your veterinary practice

- Why now?
  - Something you've thought about for years
    - Master Life Plan
    - Promise made to someone
  - Goals met- Personal/Financial
    - Done all you can as veterinarian
    - Reached financial stability



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## Deciding to sell your veterinary practice

- Why now?
  - Health Issues
    - Received bad news
    - Family history
    - Just being careful
  - Lifestyle Issues
    - Want more play, less work
    - Grandkids
    - Travel, golf, tennis, hobby



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## Deciding to sell your veterinary practice

- Why now?
  - Feels right
    - Can't put finger on it
    - Burn out coming
    - Losing the desire to keep learning
    - Can't stand clients!
  - Right buyer came along



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## Timing

- Have Financial Goals Been Met?
  - Positive personal Cash flow (income less expenses) can be achieved after selling
  - Retirement savings meeting goals
  - House paid for
  - Practice paid for
  - Practice real estate paid for

## Timing

- Burnt Out
  - Health suffering
  - Relationships suffering
  - Production suffering
  - Management suffering
  - Practice suffering
  - Pressure taking its toll
  - Grind of it all...

## Timing

- Right buyer has come along
  - Associate who works there currently
    - Ready and willing
    - Skill-set there
  - Outside associate
    - Recommended from colleague
  - Corporate

## Timing

- *Practice needs a spark*
  - *Can't take it to next level*
  - *Don't want to take it to next level*
  - *Clients, staff, you...all in a rut*
  - *First signs of burn out?*

## Timing

- Ready for next chapter
  - Deep down you know it is time
- Other Reasons
  - Need a large chunk of cash
  - Economy/town/neighborhood has turned
  - Increased/Improved competition

## Steps

## Step 1 – Post Retirement Plans

- Now what?
- Other passions to fill time/void
- Know what comes next
- Boredom/Lack of Purpose is a bigger problem for retirees than cash flow



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## Step 2 – Post Retirement \$ Needs

- Need financial plan
- What kind of income will you need:
  - Earned
    - Work part time?
    - Consult?
  - Unearned
    - Investments
    - Retirement
    - Social Security
    - Loan Payments
    - Rent



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## Step 2 – Post Retirement \$ Needs

- Does this cover your monthly nut?
  - Home loan?
  - Living Expenses
  - Insurance
  - Everything else?
- What kind of assets will you need to achieve this?
  - Retirement Plan
  - Cash and Investments
  - Buyer Note
  - Value of Real Estate
  - Other



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## Step 2 – Post Retirement \$ Needs

- How much do you need to sell veterinary practice for to make it all work?
  - Dollar Value?
  - Terms?
  - Rent?
  - Benefits?
  - Work?



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## Step 2 – Post Retirement \$ Needs

- Knowing how much you need, and when you need it by is crucial to planning your exit...



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## Step 3 – Getting Practice Ready

- Maximizing Profit
- Maximizing Value
- Think of getting ready to sell your home – start taking care of all little things:
  - Staff issues
  - Building issues
  - Equipment
  - Accounting Issues



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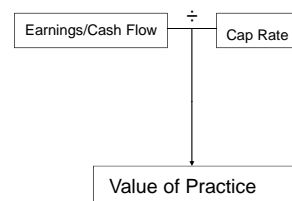
## Practice Valuation

## Why is This Important to You?

- Number you are hoping to talk away with, before taxes
- Major component of retirement strategy
- Fair and accurate valuation is critical to attract buyers
- Fair and accurate valuation is critical to buyer in making a success of practice purchase and being able to repay debt

Maximizing Profit = Maximizing Value

## Improving Practice Value



## Why Do You Care About Profit?

- Practice value is almost totally dependent on profitability
- Higher profit margin =
  - More cash to pay off purchase loan
  - Better value when you sell
- Financial statements and tax returns, even when properly prepared, do not give you an estimate of true practice profits

## Determining a Practice's True Profitability

## Determining Practice Profitability

- In small businesses, tax returns and financial statements (while properly prepared) still do not show true practice profitability
- Cash taken out of the practice does not equal profits
- Figures shown as taxable income or net income may be dramatically different from real operating profit
- Separate calculation must be done

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## Profits and Profit Margin

- Profit should represent the amount left over after all normal and necessary expenses of the practice are paid at fair market rates
- Profit margin calculated as practice profits divided by gross revenue
- Usually expressed as a percentage of gross revenue for comparison with other practices

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## Common Items That Must be Adjusted

- Owner payments
- Perks
- Services provided to practice by family members
- Facility and equipment rental
- Interest on debt
- Depreciation/amortization (non-cash expenses)
- Non-recurring interest/expense

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## Owner Payments

- Owners receive cash from the practice for multiple items
  - Compensation for medical/surgical services
  - Compensation for management services
  - Perks
  - Rent payments (facility/equipment)
  - Repayment of loans made to practice
  - Profits

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## Perks

- Perks are items not necessary to the operation of the practice but expensed by it generally to gain a tax advantage
  - Excess meals and entertainment
  - Excess auto costs
  - Swimming pool payments
  - Personal furniture
  - Trips to Tahiti
- Inclusion of perks makes the practice appear less profitable

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## True Operating Profit

Estimated profitability	Description
> 18%	Superior value
16-18%	Above average value
13-16%	Average Profitability
8-13%	Below average
< 8%	Poor

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## Step 4 – Selling

- What are your options?
- What is your timing?
- What are your terms?

## Sellers – Finding a Buyer

- Working in your practice now - Associate
  - Assess willingness
  - Assess ability
  - How to approach?
  - Selling all or partial?

## Sellers – Finding a Buyer

- Working in your practice now - Associate
  - Positives and negatives
    - Ease of transition
    - Practice stays in “family”
    - Helping those you work with/like
    - Seller financing?
    - Not much due diligence needed by buyer

## Sellers – Finding a Buyer

- Working in your practice now - Associate
  - Positives and negatives
    - No need to advertise or hunt
    - Price and terms – positive or negative? Too favorable a deal?
    - Hardball?
    - How will staff react?
    - Can you resist offering “advice”?

## Sellers – Finding a Buyer

- Working in your practice now – Manager/Other
  - Same as associate, except
    - Financing, usually need veterinarian as part of buying team
    - Clients, staff, colleagues – issue?
    - Usually best when purchased in conjunction with associate – the “team” buys the practice

## Sellers – Finding a Buyer

- Outside Veterinarian
  - Who?
    - Relief vets in area or in practice
      - » Some are looking to buy, some aren't
      - » Medical Skills
      - » People skills
      - » Management skills

## Sellers – Finding a Buyer

- Outside Veterinarian
  - Who?
    - Associates working for other practices
      - » Colleagues?
      - » Competitors?
      - » Crossing the line?
      - » Who reaches out to who?
    - Local groups
      - » SCVMA meetings, for example

## Sellers – Finding a Buyer

- Outside Veterinarian
  - Who?
    - Advertising
      - » Magazines
      - » Web
      - » Does this work?
    - Network of friends and colleagues

## Sellers – Finding a Buyer

- Outside Veterinarian
  - Who?
    - Brokers and/or consultants
      - » Clients who are buyers
      - » Extra scrutiny?

## Sellers – Finding a Buyer

- Outside Veterinarian
  - Seller Financing a possibility? Probably no.
  - Culture of the practice
  - Staff reaction? Will everyone click?

## Sellers – Finding a Buyer

- Outside Veterinarian
  - Price and terms – more difficult to come to terms? Or perhaps easier?
  - Due diligence
  - Difficulty of transition

## Sellers – Finding a Buyer

- Merger with another practice
  - Nearby practice a possibility?
  - “Loss” of your practice
  - What are you selling?
    - Client list only?
    - Tangible assets?

## Sellers – Finding a Buyer

- Merger with another practice
  - Staff?
  - What if you own real estate?
  - Can be difficult to pull off
    - Transition
    - Clients
    - Meshing two practice cultures

## Sellers – Finding a Buyer

- Corporate
  - Good price?
  - Stigma?
  - Term flexibility
  - What if you own real estate?

## Sellers – Finding a Buyer

- Corporate
  - Employment contract almost always required
    - Production
    - One year or two?
  - Staff
  - Associate veterinarians
  - Practice identity

## Terms

## Terms – Seller

- What do you want?
  - Price for Practice
    - Valuation number?
    - Feel it should receive a premium?
    - Sweat Equity discount?
  - How do you want to be paid?
    - All cash?
    - Owner financing?
    - Partial owner financing?
      - » How well do you know and trust buyer?
    - Timing?

## Terms – Seller

- What do you want?
  - Real estate Lease
    - Fair market value rent
    - Increases
    - Triple Net
    - Option to buy?
    - Right of first refusal?

## Terms – Seller

- What do you want?
  - Employment Agreement
    - How much do you want to work?
    - For how long?
    - Rate of pay?
    - Benefits?
    - Responsibilities?
    - Open ended?

## Terms – Seller

- What do you want?
  - Allocation of purchase price
    - Ordinary income versus capital gain income
    - Majority of purchase price to capital gain
    - Buyer will want the opposite – tug of war
  - Leases assumed
  - Treatment of employees
  - Special items you're taking with you
  - Future animal care

## Terms – Seller

- What will you take?
  - Less than asking price?
  - Carry partial note?
  - Adjustments on lease?
  - Other areas?

## Terms – Seller

- Deal-breakers
  - Items you just can't budge on
  - No owner financing
  - Must work for one year
  - Need health insurance for two years
  - Allocation
  - Long term receptionist must keep job

## Financing

## Financing - Seller

- Self finance most, some, or not at all?
- Positives
  - Can help get deal done smoother and quicker
  - Better rate of return than you can safely get right now
  - Can usually ask for and get favorable terms
  - Installment gain – helps with timing of taxes

## Financing - Seller

- Requiring outside financing of buyer
- Positives
  - Get your money now
  - No worries about buyer succeeding – you've been cashed out

## Financing - Seller

- Requiring outside financing of buyer
- Negatives
  - Taxes due now
  - Strain on buyer?
  - Ability to get financing may reflect on quality of practice
    - Cash flow
    - Feasibility Analysis
    - Overpriced?
  - Paperwork burden – Lots for you to do too
  - Time involved
  - May require partial owner financing

## The Team

## The Team - Seller

- Financial Consultant a must
  - Value of practice
  - Financial Terms
  - Tax ramifications
  - Negotiations?
- Lawyer
  - Drafting of documents seller responsibility
  - Negotiations?
  - Need lawyer for protection – all facets

## The Team - Seller

- Brokers
  - Practice
    - Can't find buyer
    - Can help with all aspects of transaction
    - Exhaust all options
    - Weigh cost versus benefits
  - Real estate
    - Usually hand in hand with practice brokers
- Certified Financial Planner
  - How to invest funds
  - Prepare for retirement

## Tax Issues

### Tax Issues

- Whether buying, selling, or starting from scratch, every decision can have major consequences
- Current tax law potentially in a state of flux
- Review what is potentially coming down pike

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### Tax Issues – Seller

- Drugs and Supplies – Ordinary Income Rates
- Accounts Receivable – Ordinary Income Rates
- Equipment/Furnishings/Fixtures – Ordinary Income Rates
- Covenant not to Compete – Ordinary Income Rates
- Goodwill – Capital Gain Rates
- Patient Records – Capital Gain Rates

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### Tax Issues – Seller

- Drugs and Supplies – 42% (Fed and Cal)
- Accounts Receivable – 42% (Fed and Cal)
- Equipment/Furnishings/Fixtures – 42% (Fed and Cal)
- Covenant not to Compete – 42% (Fed and Cal)
- Goodwill – 27% (Fed and Cal)
- Patient Records – 27% (Fed and Cal)

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### Tax Issues – Seller

Example 1

	<u>Price</u>	<u>Tax</u>
Drugs and Supplies	\$ 25,000	\$ 10,500
Equipment/F&F	\$ 50,000	\$ 21,000
CNTC	\$ 100,000	\$ 42,000
Goodwill	\$ 700,000	\$ 189,000
Patient Records	\$ 125,000	\$ 33,750
<b>Total</b>	<b>\$1,000,000</b>	<b>\$ 296,250</b>
<b>Tax Percentage</b>	<b>29.6%</b>	

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### Tax Issues – Seller

Example 2

	<u>Price</u>	<u>Tax</u>
Drugs and Supplies	\$ 75,000	\$ 31,500
Equipment/F&F	\$ 150,000	\$ 63,000
CNTC	\$ 250,000	\$ 105,000
Goodwill	\$ 325,000	\$ 87,750
Patient Records	\$ 200,000	\$ 54,000
<b>Total</b>	<b>\$1,000,000</b>	<b>\$ 341,250</b>
<b>Tax Percentage</b>	<b>34.1%</b>	

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### Due Diligence

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## Due Diligence

- Why do you need?
  - Buy house – have inspection done
  - Buy used car – take to mechanic
  - Buy veterinary practice – do your due diligence

## Due Diligence

- What does it mean?
  - Investigating all aspects of the practice
    - Financial
    - Operational
    - Legal
    - Other
  - Not taking their word for it
  - Pentagon: trust but verify

## Due Diligence

- Be prepared
  - Clean records
  - Clean numbers
- Investigate Buyer
  - Reputation?
  - Net Worth? Down payment?
  - Credit Scores?
  - Can he/she pull it off?

## Transition

## Transition

- Everything involved with the change of ownership
- Often the area that can sneak up on buyer/seller
- Not difficult, just detailed and painstaking
- An order in which you do things
- Example, can't open checking account until incorporated and have Employer Identification Number