

The Coming Wave

**PACIFIC VETERINARY
CONFERENCE 2011**
Tom A. McFerson, CPA, ABV



www.gattomcferson.com

The Coming Wave

- Many believe there will be a LARGE increase in the number of veterinary practices that will be coming up for sale.
- Time horizon? 2 – 7 years
- Why??



www.gattomcferson.com

Aging Baby Boomers

- According to the U.S. Census Bureau, a Baby Boomer is considered anyone born between January 1, 1946 and December 31, 1964.
- How many out there? Close to seventy-eight million people.
- Or...about 25% of our population.



www.gattomcferson.com

Aging Baby Boomers

- These folks began turning 65 years of age on January 1, 2011.
- Estimated that every day approximately 10,000 members of this group will turn 65 - retirement age.
- Straining the system:
 - Economy
 - Retirement System
 - Social Security System
 - Health Care System



www.gattomcferson.com

Aging Baby Boomers

- Many of these are small business owners.
- Many of these are veterinarians/veterinary practice owners
- How many?
 - Hard to know.
 - Estimated 25,000 privately owned veterinary practices across the country.
 - Close to 10,000 owned by veterinarians on the cusp of retirement.



www.gattomcferson.com

Aging Baby Boomers

- Many (majority??) are single doctor practices.
- Many (majority??) do not have a firm (or any) transition plan in place.
 - No associate waiting in wings...
 - No partners ready to buy them out...
 - Game plan: put on market and walk away with all cash.



www.gattomcferson.com

Aging Baby Boomers

- Is this a good plan?
- May work for a few, but probably not for the majority.
- Timing.
- Will there be a rush to the exits?
- What will impact be on market?
- How many veterinary practices can the market absorb at once?



www.gattomcferson.com

Road to Retirement

- Back on course?
- Owners watched in horror as coveted retirement was derailed by three factors:
 - Stock market crash of 2008-2009 - loss of 20-40%.
 - Real estate crash sliced all property values 10-30%.
 - Gloomy economy pulled down veterinary practice income, which in turn impacted business values.



www.gattomcferson.com

Road to Retirement

- These three factors put the drove retirement plans right off the road and into a ditch.



www.gattomcferson.com



www.gattomcferson.com

Road to Retirement

- An illustration...



www.gattomcferson.com

	Example A	Example B	Example C
Total Value of Retirement Assets	2,000,000	1,500,000	1,500,000
Age of Retirement	67	67	67
Average Annual Growth	5%	5%	5%
Annual Withdrawal During Retirement	\$ 150,000	\$ 150,000	\$ 114,000
Years Money will Last	26 (Age 93)	18 (Age 85)	26 (Age 93)

Assumes 5% average growth over life of retirement.
No tax implications have been considered.

Example A - The ideal retirement scenario. Veterinarian would begin retirement with \$2,000,000 in assets, and would be able to withdraw \$150,000 per year, which covers forecasted living expenses. Funds would last for 26 years, until age 93.

Example B and C - What many veterinarians were recently faced with. Total retirement assets drop to \$1,500,000. Under B, funds last only 18 years, until age 85. Under C, reduction of withdrawals necessary to have funds last until age 93.



www.gattomcferson.com

Road to Retirement

- Neither Example B or C were all that palatable (especially B - just don't live as long?).
- Conclusion? Many aging practice owners decided they were financially no longer in a position to retire.
- Now? Stock market is improving, and the general economy has stabilized. (maybe)
- You could argue that a solid financial is foreseeable once again.



www.gattomcferson.com

Road to Retirement

- Older practice owners are feeling more secure about future.
- Same practice owners willing to revisit selling their practices.
- Question is when?
- Question is also how many?



www.gattomcferson.com

Enough Buyers out There?

- Many say yes
- Slow accumulation of buyers that are ready, even eager, to purchase quality veterinary practices.
- Have chosen to remain on the sidelines.



www.gattomcferson.com

Enough Buyers out There?

- Shaky economy, buyers have reservations about jumping in.
- Not a lot of quality practices to choose from out on the veterinary practice market.
- Buyers have become educated about ups and downs of owning a business.
- In the past, a veterinarian could buy a practice and succeed without doing much in the way of improvement or management.



www.gattomcferson.com

Enough Buyers out There?

- 1997 to 2007 - most owners made money in spite of themselves.
- Now, survival means altering the old practice model and getting creative.
- Potential buyers have been taking notes.
- Know what works and what doesn't.
- Know difference between trouble and potential.
- Understand the emotional toll that financial pressures can take.



www.gattomcferson.com

Enough Buyers out There?

- Buyers have chosen to be picky.
 - Opting to wait for better practices
 - Opting to remain associates
 - Opting to start up own practice
 - Opting to do mobile
 - Understand that everything is not so easy. Why put yourself behind eight ball by buying weak practice?



www.gattomcferson.com

Enough Buyers out There?

- Many believe sideline packed with qualified, financially able buyers.
 - Educated
 - Savvy
 - Many have money behind them
 - Bidding Time
 - Waiting for the right fit.



www.gattomcferson.com

Enough Buyers out There?

- When sellers decide to sell...
 - Will there be the quality practices buyers are looking for?
 - Will these buyers actually be there, ready to step off sidelines?
 - Will there be enough of them?



www.gattomcferson.com

Recovering Economy = Recovering Practice Value

- Our industry learned we are not recession proof.
- Veterinarians throughout country felt the slowdown.
- Perhaps not as bad as other industries (construction, automobile), but bad enough.
- Rude awakening.



www.gattomcferson.com

Recovering Economy = Recovering Practice Value

- As the economy tanked, many veterinary practices were pulled down with it.
- Why?
 - Client visits down
 - Client spending down
 - Gross revenue down.
 - Lower revenue resulted in shrinking profits.
 - Shrinking profits resulted in lower overall practice values.



www.gattomcferson.com

Recovering Economy = Recovering Practice Value

- Poisonous cocktail:
 - Above factors
 - Tighter financing
 - Impending feeling of doom
 - No one willing to sell practice
- Like housing market.
 - Given steep decline, now not the time to sell home.
 - Same goes for veterinary practices.
 - Unless forced to (sick, divorce), most veterinarians have chosen not to sell their businesses.



www.gattomcferson.com

Recovering Economy = Recovering Practice Value

- As economy recovers and veterinary practice income improves (hopefully)
 - Value of these businesses will climb.
 - May not reach the high water mark
 - Should recover to the point that an owner can now justify selling again.



www.gattomcferson.com

Tax Implications

- Another force that may drive sellers are the potential tax ramifications.
 - Extension of the Bush tax cuts at the end of 2010, sellers are assured that capital gain tax rates will remain at 15% through the end of 2012.
 - After that, who knows?



www.gattomcferson.com

Tax Implications

- Given our nation's current deficits, not unreasonable to assume taxes may rise in the future.
- May or may not include regular tax rates and capital gain rates.
- Rumbblings the last time around had capital gains rates jumping to 25%, and ordinary income tax rates for the higher brackets jumping another 5%.



www.gattomcferson.com

Tax Implications

- Illustration



www.gattomcferson.com

Tax Issues – Seller

Example 1 – Current Rates

	<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
Total	\$1,000,000	\$ 296,250
Tax Percentage		29.6%



www.gattomcferson.com

Tax Issues – Seller

Example 2 – Possible Future Rates

	<u>Price</u>	<u>Tax</u>
Drugs and Supplies	\$ 25,000	\$ 11,750
Equipment/F&F	\$ 50,000	\$ 23,500
CNTC	\$ 100,000	\$ 47,000
Goodwill	\$ 700,000	\$ 238,000
Patient Records	\$ 125,000	\$ 42,500
Total	\$1,000,000	\$ 362,750
Tax Percentage		36.3%



www.gattomcferson.com

Tax Implications

- All things being equal – meaning value, willingness to sell, steady economy – this jump in potential tax rates may motivate some sellers to accelerate their timetables.



www.gattomcferson.com

Financing

- What happened to the credit market?
- As the recession took shape, national lenders far and wide took a defensive position.
- Money spigots were shut down as lenders assessed their loan portfolios and licked their wounds.



www.gattomcferson.com

Financing

- Veterinary lenders fared better, but not by much.
- Did their best to weather the storm.
- Of their existing veterinary practice loans, “problem” loans were three to five percent of loan portfolios.
- Compare this to the 15-25% problem loans rates of other industry specific lenders, such as construction.



www.gattomcferson.com

Financing

- Improvement in the day to day performance of veterinary practices (cash flow), should result in more lending.
- Better lending, buyers will step off sidelines.
- Seller’s willingness (now) to carry back a portion of their sales price
- Ingredients for a spike in the marketplace.



www.gattomcferson.com

All this contingent on two things:

1. General Economy Recovers
2. Veterinary Economy Recovers



www.gattomcferson.com

Current Economy in a Nutshell

- Unemployment is still high...
- Consumer Spending is still low...
- Home Values are still down...
- Stock Market is recovering...



www.gattomcferson.com

What does this mean for Veterinarians?

- High Unemployment
 - Less money pet owners have to spend...
- Home Prices down
 - Net Worth down
 - Less money pet owners feel like they have to spend...



www.gattomcferson.com

Six new economic realities:



www.gattomcferson.com

Reality Number 1

- Consumer spending down
- People are frightened about financial future
- Much less willing to part with the money they have
- Veterinary practices competing for a shrinking amount of disposable consumer income



www.gattomcferson.com

Reality Number 2

- Competition amongst neighboring veterinarians has grown fiercer
- Referrals are shrinking
- Competitive pricing growing



www.gattomcferson.com

Reality Number 3

- Practice owners forced to deal with shifting demographics
- Areas that were once expanding and thriving have been decimated by unemployment and foreclosures
- Veterinarians in these areas have seen their client lists reduced by a third.



www.gattomcferson.com

Reality Number 4

- Cheap, cost-friendly house-call practices and mobile specialists have begun to penetrate the market.
- Depending on where you sit, this has provided an opportunity or a threat.



www.gattomcferson.com

Reality Number 5

- Referral Practices have been hit on two different fronts
- General practitioners are keeping more cases and referring less
- Generally higher costs at referral practices have clients spooked



www.gattomcferson.com

Reality Number 6

- Large number of start-up veterinary practices revving up
- Want to own/run practice, but:
 - Not happy with what is for sale on market
 - Don't want to go buy-in route
 - Timing is right
 - Self portrait



www.gattomcferson.com

Hard Numbers

- For last two and a half years, tracking veterinary practice revenue growth/decline of 165 practices
- Southern California – General Practices
- Northern California – General Practices
- California – Referral Practices



www.gattomcferson.com

Hard Numbers

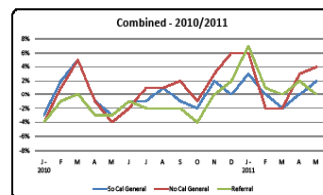
- Track monthly revenue versus same month a year ago
 - May 2011 versus May 2010
- Price increases factored out of calculation
 - Best way to monitor pure growth/decline



www.gattomcferson.com

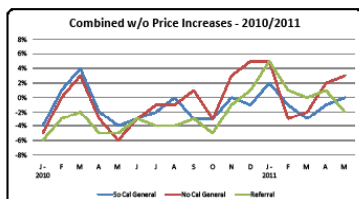
Hard Numbers

Veterinary Practice Performance in California



www.gattomcferson.com

Hard Numbers



www.gattomcferson.com

What is Happening?

- Less clients coming through the door
- Less spending by the clients that do come through the door
- Rising prices on the expense side
- Squeezing of profit margins



www.gattomcferson.com

What Practices Impacted?

- Poor Demographics
 - Less affluent areas
 - Hit hard by tanking real estate
 - Hit hard by unemployment
 - Younger areas



www.gattomcferson.com

What Practices Impacted?

- Newer Practices
 - Less established
 - Clientele not bonded to doctors
 - Unusually high debt loads
 - Competition



www.gattomcferson.com

What Practices Impacted?

- Recent Expansion
 - Higher debt loads
 - Needed revenue growth to digest expansion
 - Clients see expansion, assume higher prices
 - Pressure, less room to maneuver



www.gattomcferson.com

Some Practices Doing Well – Why?

- Good demographics
 - Affluent
 - Older, more established homeowners
 - Real estate has stabilized
 - Practice a good fit for area



www.gattomcferson.com

Some Practices Doing Well – Why?

- Good Management
 - Well priced
 - Customer Service
 - Watching Costs
 - Watching competition
 - Staff well trained



www.gattomcferson.com

Some Practices Doing Well – Why?

- Other Reasons
 - Low debt level
 - New doctor – Energy
 - New services
 - Good fortune



www.gattomcferson.com

Average US Consumer

- 2008 Total Income: \$63,091
- 2009 Total Income: \$62,857
- 2008 Spending: \$49,638
- 2009 Spending: \$49,067



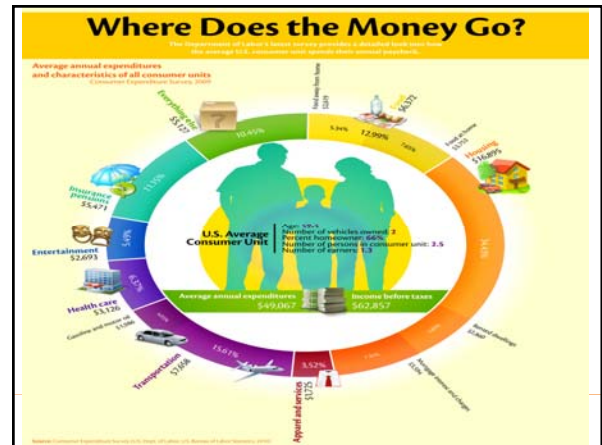
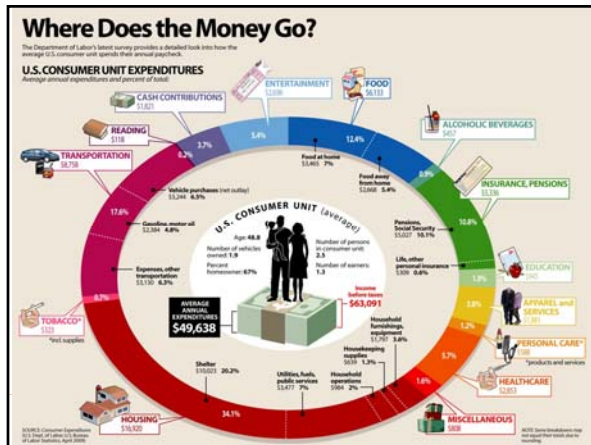
www.gattomcferson.com

Average US Consumer

How are they spending their money?



www.gattomcferson.com



Disposable Income

- After housing, car, medical, insurance, retirement, education, church...what is left?
- 2008: \$13,005
- 2009: \$14,317



www.gattomcferson.com

This is what we're competing for...

2008: \$1,083.75 per month

2009: \$1,193.08 per month



www.gattomcferson.com

This is who we're competing with...

- Entertainment
- Food
- Cigarettes/alcohol
- Clothes
- Personal Care
- Everything/anything else!



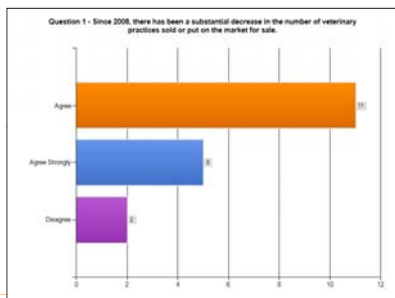
www.gattomcferson.com

Don't just take my word for it...

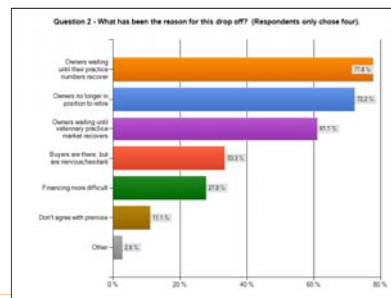
Eighteen attorneys, lenders, CPAs, brokers, consolidators and consultants that are actively involved in the purchase and sale of veterinary practices were surveyed on this topic. Here are their responses:



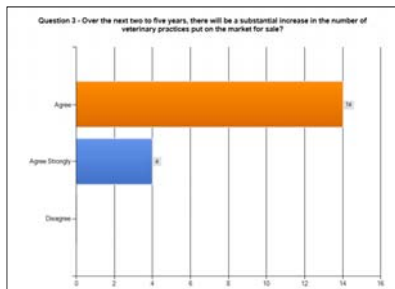
www.gattomcferson.com



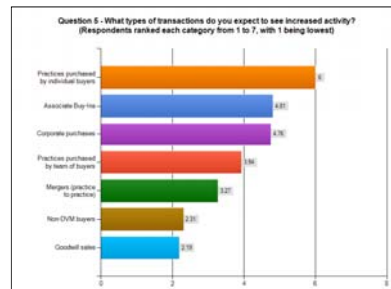
www.gattomcferson.com



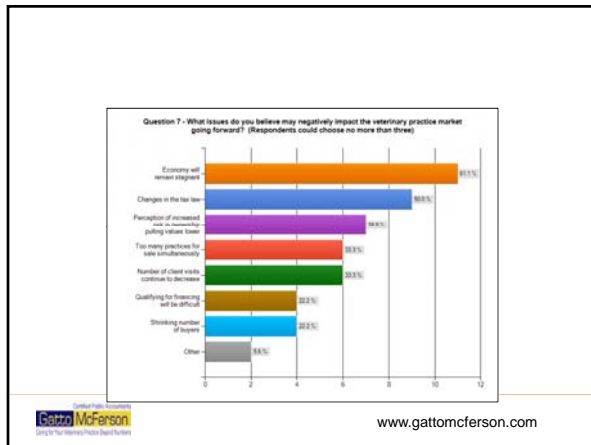
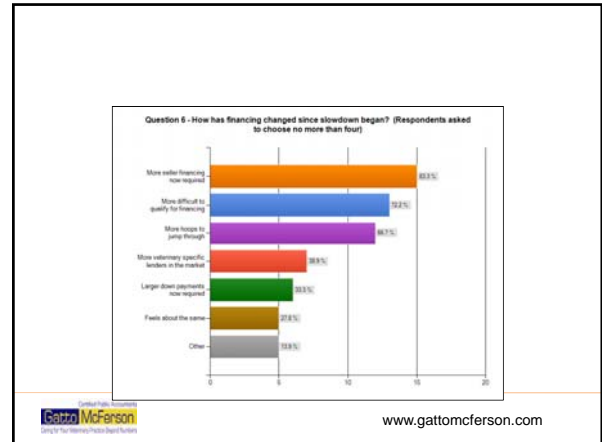
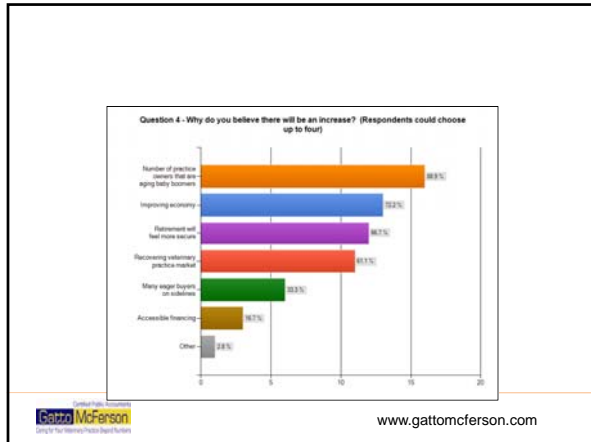
www.gattomcferson.com



www.gattomcferson.com



www.gattomcferson.com



- ## How to Capitalize...
- Sellers:
 - Plan ahead
 - Maximize Profits
 - Maximize Value
 - Develop Exit Strategy that is ready to implement
 - Consider all options
 - Buy In
 - Merger
 - Records Sale
 - Flexible on Terms
- www.gattomcferson.com

- ## How to Capitalize...
- Buyers:
 - Keep finger on pulse of market place
 - Down payment - cash speaks loudly
 - Pre-approved for loan
 - Know what you want
 - Consider all options
 - Step Buy In
 - Partnership
 - Flexible on Terms
- www.gattomcferson.com

Copy of slides by email?
tom@gattomcferson.com

www.gattomcferson.com

Questions?

