Dreaming of owning your own veterinary practice? Wishing to be your own boss and enjoy the satisfaction of building your own clientele?

There are numerous myths and falsehoods that discourage young veterinarians from acquiring their own practice, and some that make selling a practice seem to be an insurmountable hurdle. As consultants, immersed in the industry on a daily basis, too often we hear many of these comments. Unfortunately for buyers and sellers alike, they can be quite disruptive. Maybe some of these sound familiar:

I have no money for a down payment, so I can’t buy a practice.
Zero to 5% down is an achievable arrangement, so not having a down payment is not the biggest hurdle in purchasing a practice.

Banks always want a 20% down payment.
No, they don’t. Conventional home loans need 20% down, practice loans often do not.

I have student debt (with good credit) so I can’t afford to buy a practice.
A practice pays for itself out of its own profits, so if a buyer has good credit and reasonable experience in practice management, he or she can always afford the practice unless the buyer has really poor finances. For example: $145K in student debt instead of the more typical $80K, $24K annual alimony/child support, and high-expense tastes.

I should work in the practice for a while before I buy it.
FALSE. Hiring the buyer for a month or two before selling usually is not very successful. Buyers generally start to change things too soon, or reach conclusions prematurely. Even though they don’t own it, they may act like it. This causes conflict between the prospective buyer and seller and can cause a deal to go sour. A smooth transition period following the sale is of greater importance.

Practices lose about 15% of their clients the first year after sale.
FALSE. Our statistics indicate that growth of more than 20% after a sale is typical. This is likely due to the “new blood” and energy a younger, more dynamic doctor brings to the practice, offering new services, with more modern marketing.

All practices are worth 70% to 80% of gross.
FALSE. In fact, some are worth as little as 25% and some as much as 125%. Practice profits, not just gross revenues, are the decisive measure.
**Goodwill value is always five times earnings.**
FALSE. Actually, the value of goodwill commonly ranges anywhere from two to seven times earnings in the veterinary industry, with three to five being average. Some appraisers use upward of 27 different line items to determine the multiple, or “cap rate,” and also take into account the unique nature of the practice. Both qualitative and quantitative in nature, these items help to personalize the appraisal methods to the individual practice.

**I take cash out of my practice (non-reportable) so I want to add it back to profit.**
Then you have essentially sold your practice on the installment plan. A veterinary appraiser can’t work off of unreported money. Every unreported dollar represents a tax savings of 25-35%. On the other hand, every reported dollar will net a seller three to five times that amount in practice valuation. Taking $20K in unreported cash out of the practice might save an owner approximately $6K in taxes, but would cost an average $60K to $100K in value. This is a big mistake, so don’t do it.

**I run all kinds of stuff through the books, and then add it all back to profit.**
Lenders are quite intolerant of this, plus its borderline illegal from a tax point of view. It’s best to strictly separate personal and practice expenses, take higher profits, and then pay more tax during the last couple of years prior to a sale. The books will be “clean” and the buyer and lender will love the propriety. When a seller tucks thousands of dollars’ worth of personal expenses into the practice, these often will not be accepted by the lender. The practice, in the lender’s eyes, has less to spend on debt service. Padding expenses can mean the difference between getting an extra $100K in loan money or not. In extreme cases, it can mean the difference between loan approval or denial.

**My practice is different, special, the best in the area.**
Everybody thinks their practice is special. However, rarely is a practice so well managed that it would receive high marks in all areas. Although it may be nicer than some others in the community, it probably still has some management deficiencies overall. Realistically, most practices are probably about average but owner over-valuation is quite common because owners are rarely exposed to enough other practices to compare accurately.

**Small practices have lower prices so they are more affordable and easier to finance.**
Small practices have small profits. A practice grossing $200K per year likely produces $60K to $75K. Allow a reasonable doctor salary of $60K to $75K (most buyers need this much due to high student debt, plus general living expenses) and you have a practice with little or no earnings. Since the loan payments come out of earnings, zero earnings make zero payments.

**I should sell a small percentage of my practice each year to my associate.**
The percentage buy-in has been around for years, and perhaps had the most application in the absence of commercial financing, and practice pricing without direct reflection to appraised value. Today we are witnessing a resurgence of this approach in veterinary medicine. Although beneficial in many cases, especially to the buyer, there are very few sound reasons financially for a practice
owner to select this approach. A 100% owner receives 100% of the profits above all expenses, including the owner’s reasonable veterinarian salary. If a junior owner gets 20% and the senior owner receives 80%, the junior uses the 20% in profits to cover the cost of the loan payments. Essentially, the junior is handing back the senior his own money. Initially the senior’s income doesn’t change much. Salary + 80% + loan payments. When the loan is paid off and the junior owner purchases additional percentages in the practice, eventually the seller has a much lower percentage of management duties, so the senior may do the same amount of work for less money. This can be an unattractive situation for the seller.

Buyers who think through the implications don’t always like the idea of buying part when they can afford to buy it all. Since a practice’s value is based on earnings, the practice has the capability to generate funds to pay for itself entirely, or some portion thereof.

There is only one time an arrangement of this type makes financial sense, and that is when this type of practice is less desirable in the open marketplace, or associates are very difficult to attract and retain. You get associates to guarantee they are going to stick around, because they are part owners, and because they cannot easily sell their small percentage to someone else. This is a variation of the “golden handcuffs” rule, which encourages the buyer to continue on in the practice, and eventually buy the entire practice.

**Sell the company stock rather than structuring it as an asset sale.**

Sellers love the idea, because lower capital gains taxes are incurred when selling a C corporation. In cases where a buyer actually considers purchasing C-corporation stock, buyers should negotiate to pay less for a stock sale in overall purchase price than for an asset sale. Since they pick up the depreciation schedule where the previous owner left off, buyers will have less depreciation and more profit subject to taxes than in an asset sale where the depreciation clock starts over. What’s more, in a C-corporation purchase, the buyer picks up the corporation’s liabilities, legal and financial, known and unknown.

**Large practices are only for very experienced veterinarians, because they are ten times more difficult to manage than a $200K practice.**

Although larger staffs do require more work, it’s not vastly more work. Five staff members can be just as demanding as 25. Big practices can usually afford to handle the challenges: sending staff to HR training, advanced marketing to improve profits, staff training, hiring more staff to ease the workload and stress, and employing middle management like an office manager, inventory clerk, and chief of staff. The margins are usually greater, so these practices tend to tolerate more fluctuations in financial performance. If you’re going to buy a small practice, your practice-management skills will have to be at their highest level, because your margins will be so tight.

**As long as the profit is high, any practice in any geography will sell easily.**

Location is hugely important. A marginal practice in a coastal area in California can sell significantly faster than a high-profit practice in North Dakota. A distressed practice on the best, fastest-growing side of town will usually sell quicker than a nice practice in a crime-infested, low-income ghetto area. Rural practices are becoming much harder to sell because the majority of young veterinarians come from larger urban areas and are less inclined to live in a small town.
Location, Location, Location doesn’t apply to veterinary practices.
A well-positioned practice with good parking on a main street with good curb visibility will out-sell a practice with similar profits in a bad location on the same side of town. Offering superb service in a bad location will have a slight influence, but it will usually not be enough to overcome the advantage that a good location commands.

Buyers will accept a low personal income for a few years “like I did back in ’64.”
Not necessarily true. These days, prospective buyers are strongly focused on family and personal well being. Many buyers also have very high educational loan costs compared to 20 or 30 years ago, so they tend to opt for immediate pay-offs. For others it’s family focus and working smarter rather than harder. Many older veterinarians struggling to hire associates complain that today’s younger graduates don’t want to work as hard. As a whole, that’s likely untrue. But most will agree prospective buyers do have substantially different priorities. Times change, so must the industry.

Practice type has no bearing on the valuation of the profit stream generated (discount spay/vaccine vs. traditional day practice).
If I generate profit by being the lowest-cost practice, my income stream is highly unstable and subject to volatility and market shift. If I charge strongly but fairly, do a great job, cater to those who want value, i.e. price balanced with good service, then my income becomes more stable and risk free. As a buyer, it’s worth more to buy a stable profit stream with high likelihood of continuing.

Average the last three years’ gross, then use that gross figure for valuation methodology.
Simple averaging of data is usually inappropriate. The majority of good appraisers use weighted averages, not straight averages. The most recent year should receive more consideration than three years ago. And it’s easy to imagine that a buyer would pay more for a practice that was first grossing $500K then $750K then $1.0M, rather than one that was doing $1.0M, which then dropped to $750K and dropped again to $500K. In both cases, the straight average is $750K, but an informed buyer would not pay the same amount for these two practices. The “winning” practice that clearly shows growth is worth more.

No one can afford to buy my high-grossing practice.
Higher gross (assuming correspondingly higher earnings) means the practice has that much more profit to use on the bigger loan. If the practice has $500K in cash flow, the doctor doesn’t need $390K on which to live. A personal budget of $100K allows $400K to go toward the loan. Also, one might think that a $1.5M practice requires a $300K down payment (people frequently equate it to 20% down on house loans). This is not necessarily true, as buyers can often buy a practice with 0 to 10% down. That means the buyer could likely make this type of investment with only $50,000 down. High-grossing practices often sell to non-corporate (consolidator) buyers. Many commercial lenders are eager to work with buyers of large practices. For some sellers, a consolidator is a good fit for reasons other than buyer affordability.
My associate has no money so cannot buy my practice.

Outside of the small down payment, the practice, not the buyer, pays for the loan payments in the form of redirecting earnings. Earnings that used to go to the seller as profits, now go to the lender in the form of loan payments. Most buyers can find a 5% down payment with the aid of small loans, family money or savings.

How can you evaluate my practice without knowing the exact equipment value?

When using a capitalized earnings approach, the business as a whole is valued, making the assumption that all of the items present, equipment, inventory, staff, etc. are necessary to produce the profit stream. By valuing the profit stream instead of the individual assets, it eliminates the need to figure out each asset value with high specificity. Also, since it is difficult to argue the true “used” value of any item, and since equipment in moderate to large practices usually only makes up 10% to 20% of the overall value, it doesn’t matter as much if you’re tweaking this relatively small equipment value component up or down a couple of thousand dollars, when the remaining 80% of the value is not equipment dependent. When a specific equipment value is rendered in an appraisal, be sure to acknowledge that it’s an educated estimate, and not a guarantee.

I want to find a new associate to sell part of my practice to now, and the remainder when I retire.

While appearing simple, this premise is truly difficult to achieve. Most buyers would only consider buying into a practice after they had already worked there for an adequate trial period. If they do, see the section on page 5 about the “golden handcuffs” rule.

Veterinary practices have no goodwill value.

Even low-profit practices have some goodwill, since goodwill isn’t just profit based. It’s a recognition of the value that the preexistence of the practice, practice name, etc. has within the community. It’s important not to confuse goodwill value with “blue-sky.” While the two terms are often used interchangeably, they are quite different. These differences will be addressed later in this book.

My practice is worth more because it has lots of equipment.

In general, “less is more.” If one can generate $300K in profit from $100K of equipment rather than $200K of equipment, more is actually being done with less. Large investments in equipment only have relevance to value if the practice can make full use of the equipment to create profits. Also, what if your payments on equipment are higher than mine? Do you really need and know how to use all of that stuff? If you buy a $30K ultrasound that costs $800/month in payments but it sits in the corner getting dusty, it’s costing, not making, you money. If a practice has $150K vs. $100K in equipment, and if the profit is no higher or is in fact lower, this situation doesn’t make the practice with $50K more in equipment worth $50K more overall.

I should offer less because I want different software, a pulse ox machine, and a new x-ray machine.

The price and the appraised value is based on what is there now, not what will be there someday, after changes. If the practice can produce $500K in income with the current computer system, then
that’s what is being sold. Justifying the purchase of new equipment requires an increase in corresponding future revenues. If the proposed equipment purchase will not increase revenues or reduce costs, then it might be a luxury item and, therefore, unnecessary. On occasion, a buyer may misinterpret a consultant’s advice on how much to pay for a practice. If the consultant has included his client’s wish list of equipment, staff, and other changes, the consultant will render a “price” that his client (the buyer) can afford. This amount may not be equivalent to the practice’s current fair market value.

**I should discount the price to my associate.**

Do so out of the goodness of your heart. There is, however, no business reason to do so. Associates, regardless of how hard they have worked or how much they have helped build the business, do not own any of the clientele, and are not entitled to it. That’s simply what employees are supposed to do: work hard, do a good job and build up the sales or services of the company they work for. That’s why we pay them and, where appropriate, pay them bonuses when they do exceptionally well.

**As a long-time associate, I own some of the goodwill.**

These employees often feel “entitled” to something, but they have no legal claim to it in most cases. They were paid, and hopefully paid well, if they were directly responsible for significant growth, and that is their reward for helping to grow the practice. The owner is the only one assuming the risk (risk of bankruptcy, risk of lawsuit as the business owner, responsibility for employee problems, payment of loans, etc.), not the associate. That’s why the owner owns all of the practice, including goodwill. Owners take the risk. Their name is on the bottom line.

**A buyer will pay for potential.**

If there is potential, the person who develops it should be rewarded. A buyer’s decision to purchase should be influenced by potential, but the dollar amount on the check is payment for what is received, and that means what’s right there, right now. Sellers sometimes want to get paid for future potential. Sellers first need to create it, collect the profits, show it as earnings, and then the commensurate value can be increased to account for the harvested potential. Outside of special circumstances surrounding very fast growing, young practices, potential is rarely, if ever, an additive item to current dollar value, especially when viewed by an educated buyer.

**Women won’t buy veterinary practices.**

Women now purchase half of all practices currently sold in some parts of the country, and the number of prospective women buyers is on the rise nationally. According to results from a recent study by VetPartners, women are buying practices on par with men. Women realize that freedom is the most highly motivating reason for owning their own business, a goal that’s recently become quite attainable, and is no longer just for men. Both men and women wish to balance personal and professional lifestyles. Women are more likely to prefer urban, multi-doctor practices that have good profits and the ability to tolerate flex-scheduling.
I have huge student debt, car payments, and house payments so, when I evaluate the practice, it’s worth a lot less to me than what the seller says it’s worth.

The practice is worth what it’s worth. When that value has been rendered by a professional appraiser, you can take it to the bank literally. Just because you can’t afford a Lear jet or a 10,000-square-foot house doesn’t make them worth any less. The market controls that, not your ability to pay a certain price. Admittedly, you may not be able to afford the price, but the item itself is not worth less because you can’t afford it.

There are certainly many more wives’ tales and other untruths in the marketplace but these represent some of the most frequent. As you can see starting or buying a practice is well within your grasp provided everyone is logical, realistic and works from the basis of fact rather than fiction. Owning a practice can be one of the most rewarding experiences in life and certainly one of the most financially impactful. If you plan well, success is waiting for you.