1. Introduction

Shock! Disbelief! Owners are devastated when they learn their practices are worth only a fraction of what they anticipated as they approach retirement and contemplate a sale. However, if you can understand why this occurs and identify if your practice is at risk, you can begin the process of recapturing this lost value for your practice.

Veterinary practice appraisers have always observed a relatively small pool of low-value practices. Often referred to as Mom-and-Pop practices, these generally consisted of solo practitioners delivering dated medical services and producing low profits each year.

However, in recent years, appraisers have seen an increase in the number of practices with no value or an exceptionally low value (i.e., No-Lo Practices). Quite unexpectedly, appraisers are also observing a significant change in the mix of practices occupying the low-value end of the spectrum. In addition to the normally predominant Mom-and-Pop practices, this end of the spectrum is currently experiencing an increase in the number of practices traditionally expected to be profitable—practices that offer quality, progressive medicine with the latest equipment; are located in new, state-of-the-art facilities; and offer above average compensation packages to doctors and staff members. Owners in these practices may take home more than $200,000 per year but still have No-Lo Practices.

The common thread linking all these practices is poor profitability in relation to gross revenue generated. To make matters even worse, most owners of these low-profit practices are not even aware of their perilous financial situation and discover the gravity of their situation only as they prepare to put their practices on the market.

Answer this question: Do you view practice ownership as job security or as an investment? Those who see ownership as job security praise the autonomy and control they gained by becoming owners. Those who view practice ownership as an investment report varied expectations. Some say they are content to break even (i.e., just get the bills paid every month), whereas others say they expect re-
turns on their investment as high as 25% or 30% each year.

Most owners want their practice to provide them with more than mere job security. They want practice ownership to act like an investment and to build wealth for their retirement or for their heirs. However, for an ownership to act like an investment, owners have to view their practices as investments.

If you own or plan to own a veterinary practice, keep reading. The steps you take now can have a significant impact on your practice value and your ability to attract a qualified buyer. Even if your practice generates enough money to meet your personal and practice cash flow needs, would a potential buyer find that sufficient? Your needs are different from what a buyer may expect from your practice. After all, a buyer will be making payments on debt to acquire your practice and will expect the practice to generate those funds.

Just as you recommend regular exams for your clients’ animals, you need to conduct a self-exam on your practice’s health. In particular, you need to examine your true profit, which is an important component of practice value. Unfortunately, that hasn’t been easy to do. The accounting principles that drive the reports you see are largely tax-driven (i.e., your financial statements are designed to minimize your profits to reduce your income taxes and not to give you a snapshot view of your practice’s financial health).

In the absence of a reliable method for knowing if your practice is financially healthy and thus building value, you may own a practice that has little or no value. In the last few years, the number of practices with no value or low value has increased—to the point where the Veterinary Valuation Resource Council of VetPartners coined the term No-Lo Practice to describe these businesses.

Imagine you’re a practice owner a year before you plan to retire. You’ve spent the last 30 years building an ambulatory and haul-in equine practice that is now debt-free and operates from a modern and attractive hospital facility you own. You feel your practice is very valuable because of the cash you are able to pay yourself each year—as the sole owner of this unincorporated business, you take home more than $275,000 per year. Two of your three very capable associates are interested in forming a partnership and buying your practice when you retire.

In anticipation of the sale, you hire a veterinary practice appraiser who asks you for data about your practice, analyzes the data, and gives you a report saying that your practice—which grosses $1.5 million annually—is worth only $210,000. You are stunned! How can that be? You say to yourself that the appraiser must have done something wrong.

Is this the kind of news you want to get just as you’re ready to retire? You thought your practice was worth somewhere between $1.2 and $1.5 million, based on gross fees. How could you have been so far off?

Unknown to you, your practice was showing No-Lo symptoms for several years. Lack of profitability is the single most critical underlying factor resulting in a No-Lo Practice. However, the second most common factor is a lack of owner awareness that the practice was not profitable. Symptoms of low profitability can include the following:

- Mature practices with the owner approaching retirement with no debt
- Large, multi-doctor practices with high fixed costs from a facility that’s too large or too expensive in relation to its revenue
- Large, new facilities that generate little growth in either revenue or profits
- No or artificially low rent paid to the facility owner, who is also the practice owner
- High payroll costs as a result of being overstaffed or from paying high labor costs necessary to compete in a tight local labor market
- A practice location where client demographics are marginal—with limited discretionary income and/or a shrinking horse population
- Infrequent or inadequate fee adjustments as costs rise
- Periodic cash flow crunches characterized by a lack of cash reserves to cover the normal seasonality of equine practices
- Increasing client accounts receivable (i.e., clients don’t pay at the time services are rendered)
- Excessive giveaways and service discounts
- Excessively high inventory levels and poor inventory management
- Lack of internal financial management systems (i.e., owners watching the bank balance but not the key performance indicators)
- Major equipment acquisitions but minimal training and limited use of that equipment, resulting in inadequate revenue production associated with the equipment
- Continual reliance on debt as the means to finance or lease ongoing equipment and technology needs, rather than relying on cash from prior practice profits

With adequate investigation into the underlying causes, almost all low-profit practices can recover and become increasingly profitable once again. Remember, however, that lost profits cannot be recaptured, so don’t delay treatment. Every dollar of lost profit represents $3 to $5 of lost value.

The first step in treating a No-Lo Practice condition is acknowledging that profit isn’t a four-letter word. Practice profits enable owners to pay reasonable salaries and benefits, cover all operating expenses, reinvest in the practice by maintaining and upgrading equipment, and still earn a reasonable return on the owner’s investment.

The second step is to learn how to calculate your
true profit and identify areas of opportunity to improve your profitability. So go to www.ncvei.org and complete the Equine Profitability Estimator worksheet, which was specifically designed to determine your equine practice’s true profitability. Next, identify your areas of opportunity to improve your profitability—reduce expenses, grow revenue, or a combination of the two. Then develop an action plan to tap into your opportunities. With a little effort, you can improve your cash flow, profitability, and practice value.

For more information on this subject, visit www.vetpartners.org and download “Avoid Being a Practice Worth Less” and “Valuation Essentials for Veterinarians.”

VetPartners Veterinary Valuation Resource Council Members: Lorraine List, CPA, CVA, Co-Chair; David King, DVM, AVA; Jim Stephenson, DVM, Co-Chair; Carl Lacher, CPA; Elizabeth Bellavance, DVM, MBA, CMA; David McCormick, MS; Jason Castner, CPA, CVA; Larry McCormick, DVM, MBA, CBA; Karen Felsted, CPA, MS, DVM, CVPM; Tom McFerson, CPA, ABV; Dave Gerber, DVM, AVA; Tina Oh, CPA, ABV; Dick Goebel, DVM; Michael Porrello CPA, CVA; Gary Glassman, CPA; Nikki L. Quenette, CPA, CMA; Jim Guenther, DVM, MBA, MHA, CVPM, AVA; Jim Remillard, MPA, CVPM; Michael Hargrove, DVM, MBA; Karl Salzsieder, DVM, JD; Glenn Hanner, CPA, CITP, CVA; Karen Simmons, CPA; Denise Tumblin, CPA.

©2010 Veterinary Valuation Resource Council, VetPartners. All rights reserved.