How to Buy a Veterinary Hospital
November 13, 2018

Presented by:
Terence M. O’Neil, CPA, CVA
Katz, Sapper & Miller

What is Pet Poison Helpline?
- 24/7 animal poison control center
- Veterinary & human expertise
  - 20+ DVMs
  - 75+ CVTs
  - DACVECC
  - DACVIM
  - 10 PharmDs
  - 2 MDs
- Case fee of $59 includes
  - Unlimited consultation
  - Fax or email of case report
- Educational center
  - Free webinars (archived)
  - Tax tools
  - Wheel of Vomit
  - Pet of Poisons (toxic plants)
  - Textbook
  - iPhone app
  - Newsletters for vet professionals
  - Free resources for clinics
    - Videos
    - Electronic material
    - Clings
Email us for info!
Financial Protection

• Professional Overhead Expense
• Disability – LTD and STD – including maternity
• Life Insurance
• Critical illness
• Hospital indemnity
• Association Health Plans – update

Speaker Introduction

Terence O’Neil, CPA, CVA
Katz, Sapper & Miller

Buying a Veterinary Hospital Business Valuations

November 13, 2018
Terence M. O’Neil, CPA, CVA
Fundamental Steps in the Appraisal Process

- The Big Picture
- No Bull
- Snake in the Grass
- Finding the Treasure
- The Web
- The Package

What Is Value?

The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties have reasonable knowledge of the relevant facts.

(Revenue Ruling 59-60)

Fair Market Value Definition

Valuation Versus Calculated Value Report

- **Valuation Report** – Complete analysis of company, market, industry, competition, and many other factors.

- **Calculated Value Report** – Valuation analyst and company agree on the specific valuation methods, valuation approaches, and procedures to be performed.
Upfront Matters to Consider

- Critical items to discuss amongst parties at the beginning:
  - Deal structure:
    - Asset versus stock sale?
    - Seller financing?
    - Asking price?
    - Real estate – sell or lease / seller debt covenants
    - Assumption of debts?
    - Exclusivity terms – length
    - Confidentiality agreement

- More critical items to discuss amongst parties at the beginning:
  - Seller tax consequences – they need to know the net after tax cash flow. Has seller discussed the possible sale with tax and legal advisors?
  - Covenants – solicitation and competition for seller
  - Buyer – obtain pre-approved financing?

Valuation Purpose

- Shareholder redemption or buy-in (buy – sell)
- Sale
- Merger
**Information Request**

- Five years financial statements & YTD
- Five years tax returns
- Five years practice management year-end reports and YTD
- Associate DVM contracts
- Fixed asset schedule
- Inventory schedule
- Employee census
- Summary of employee benefits
- Fee schedule

**Information Request**

- Customer concentration
- Maintenance agreements
- DVM production by doctor
- Owner DVM production
- Owner discretionary fringe benefits
- Listing of other non-recurring or extraordinary expenses
- Pending litigation
- SWOT analysis (usually done together)

**Window-Dressed Business**

- Review of financial information
- Trends
- Fees
- Equipment additions
- Method of accounting (and or change thereof)
Demographic Study

- Competition
- Pricing comparison
- Client zip code analysis – where are the clients coming from?
- Economic study of geographic area – trends
  - Median income
  - Education
  - Population growth, stagnant, or declining?

Associate DVM Contracts

- Executed?
- Term
- Non-compete terms – enforceable?
- Non-solicitation terms
- Non-hire terms
- Compensation terms
- Hours expectation
- “On-call” terms
- Benefits
- Any other non-documented understandings?
  - Associates promised an opportunity to buy?
Define the Assignment

- What is being appraised?
- When is the appraisal’s “as of” date?
- Why is the appraisal being performed?
- How is value to be defined?
  - Full appraisal
  - Limited appraisal
  - Hypothetical

Attributes of Control - Control vs. Minority

- Appoint management
- Determine comp
- Set policy
- Acquire and liquidate assets
- Negotiate contacts

- Make acquisition
- Liquidate
- Sell treasury stock
- Declare dividends
- Change bylaws and articles

Example of Relationships between Minority Interest Discounts, Control Premiums, and Discounts for Lack of Marketability

*Control shares in privately held company may also be subject to some discount for lack of marketability, but usually not nearly as much as control discount.*

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No Bull

Gathering the Non-Financial Data

- Management interviews
  - Practice management
  - DVM chief of staff
  - Is business turnkey?
  - Culture of hospital
  - Standards of care
  - Associate DVM ACT analysis
Purpose of Management Interview

- Assess risk and qualitative factors influencing value
- Observe assets
- Judge competency of management
- Interview others

Fundamental Steps in the Appraisal Process

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Snake In The Grass
Purpose of Analyzing Company Financial Statements

- Identify non-GAAP accounting issues
- Identify unusual or non-recurring items
- Identify unusual or non-essential assets
- Identify trends
- Identify differences from industry norm
- Specific comparison to guideline comparisons
- Assistance in analyzing forecast

Determining Risk

- Business risk
- Financial risk
- Liquidity risk

Quantitative Risk

- Size
- Growth
- Liquidity
- Profitability
- Turnover
- Leverage

Qualitative Risk

- Management
- Diversification
- Market position and market share
- Supplier dependence
- Lack of access to capital
- Private company managed to minimize tax
- Public company growth through acquisition
### Fundamental Steps in the Appraisal Process

- **The Big Picture** – Define the assignment
- **No Bull** – Gather the data
- **Snake in the Grass** – Analyze the data

#### Finding the Treasure
- The Web
- The Package

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### Ratio Analysis

**Dupont = ROE =**

\[
\text{Profitability} \times \frac{\text{NI}}{\text{Sales}} \times \frac{\text{Turnover}}{\text{Assets}} \times \frac{\text{Leverage}}{\text{Equity}}
\]
Normalize Earnings

- Review of historical data
- Typical adjustments
  - Owner compensation
  - Owner family members on payroll
  - Owner fringe benefits and discretionary expenses
  - Rent
  - Depreciation & amortization
  - Non-recurring expenses
  - Interest expense

Earnings to Capitalize

- Earnings to use for valuation
- Most recent year
- Simple average
- Weighted average
- We will discuss illustrations later

What Are Commonly Used Valuation Approaches?

- Income approach
  - Discounted future returns method – projection then discount
  - Capitalized return method – multiply normalized earnings by an amount that equates risk, companion typically 5x
- Market approach
  - Comparable public company method – NA but need to consider VCA information or other consolidator
  - Private transaction method – Brokerage supplied data
- Asset approach
  - Net asset value method
  - Liquidation value method
How Does A Valuator Develop Discounts/Capitalization Rates?

- Use of empirical data to support risk assessment using a multitude of methods, studies and data gathering
- Ability to assess risk

Risk Versus Return

- Risk-free rate: 2.0%
- General equity risk premium: 8.0%
- Small stock size premium (tenth decile): 5.8%
- Specific risk premium: 6.0%
- Cost of equity capital for subject: 21.8%
Determining Discount Rate Using the Build-up Method (TO Method)*

- Can the buyer accomplish the following:
  - Finance the deal?
  - Repay the bank over a reasonable term and rate?
  - Pay the taxes?
- If any of the above are answered “no,” the business is overvalued.
- We will illustrate the above methodology later

* See Excel spreadsheet

Company-Specific Risk Premium

- Evaluators judge company risk versus public market
- Revenue size
- Growth limitations?
- Industry risk and commonly used multiple of 5x
- Associate DVM’s
- Leverage
- Concentration of customer base
- Key person dependence or small management base
- Workforce
Market Approach

- VCA - Price to earnings ratio Jan. 12, 2016 – 25.03
- Forward P/E ratio – 22.79 (one year)
- Companion net before corporate adm. – 13%
- Broker databases

Asset Approach

- Net asset value method
  - Generally used for holding type entities
- Liquidation value method
  - Generally used for companies with poor financial performance
  - Orderly liquidation
  - Forced liquidation

Fundamental Steps in the Appraisal Process

- The Big Picture – Define the assignment
- No Bull – Gather the data
- Snake in the Grass – Analyze the data
- Finding the Treasure – Apply Valuation Methodology
- The Web
- The Package
Factors Affecting Value

- Historical growth and profitability
- Synergy
- Size/market share
- Geographic protection
- Management strategy

- Customer diversification
- Growth potential:
  - Top-line and bottom-line
  - Competitive position
- Value of similar companies
Fundamental Steps in the Appraisal Process

- The Big Picture – Define the assignment
- No Bull – Gather the data
- Snake in the Grass – Analyze the data
- Finding the Treasure – Apply Valuation Methodology
- The Web – Arrive at a conclusion of value

The Package

Valuation Report

- Summary letter
- Company description
- Sections summarizing
  - Relevant valuation theory
  - Methodology
  - Procedures
  - Analyses
  - Conclusions
- Valuation synthesis and conclusion
- Exhibit section
- Listing of data and documents utilized
- Limiting conditions statement
- Appraisal certification
- Appraiser professional qualifications
See Examples of Valuation

- Separate Excel spreadsheets
- Variables and affect on value
- Excel spreadsheet for members to use to analyze a hospital

Other Matters

- Trends
  - Lending
  - Sellers
  - Demographic of graduates
  - Increased competition
  - Industry challenges
  - Consolidators
- KSM negotiating tactics

- Selling never makes financial sense!!
- Sellers must... Know your number!!
- Debunking the myth
  - Sale to associate model 9x v. 6.5x
- Consolidator exits?
  - Private equity firm strategies
  - What happens in 3-5 years?
  - Number of retiring veterinarians
### Term Sheets
- Lease terms
- Employment term
- Seller financing – installment sale
- Retained equity – seller stock

### Earn Outs
- Revenue contingent
- Net Income targets
- Employee benefits
- Corporate overhead allocation
- Pricing
- Information systems
- National vendors

### Mars acquisition of VCA
- See spreadsheet of analysis
- Monthly Payment plans
- Trupanion next?
- Technology
  - Telemedicine
  - Black box of data
  - Leverage of DVM's
• How to structure sale to non-licensed Veterinarian

• See example

• Trends
  - Lending
  - Sellers
  - Demographic of graduates
  - Increased competition
  - Industry challenges
  - Consolidators – approximately 25 - 30

• KSM negotiating tactics

A Guide to Best Practices
Text KSMVet to 66866
Thank you for attending!

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1. When will I get my CE certificate? We’ll email it to you within 24 hrs.
2. I attended the webinar but wasn’t the person who logged in. Can I still get interactive CE credit? Yes. Send your name and email address to info@petpoisonhelpline.com by 2pm CST on November 14th, 2018 (strict deadline).
3. Can I watch the recorded webinar online for CE credit? Yes. You can receive non-interactive CE credit. Go to the “For Vets” page on our website, www.petpoisonhelpline.com for more info.

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